

1 BEFORE THE
2 ILLINOIS COMMERCE COMMISSION

3 ILLINOIS-AMERICAN WATER COMPANY,) DOCKET NO.
4 CITIZENS UTILITIES COMPANY OF ILLINOIS) 00 -0476
5 and CITIZENS LAKE WATER COMPANY)
6 Petition for Approval of Proposed)
7 Reorganization and Affiliated Interest)
8 Agreements, Issuance of Common Stock)
9 and Debt Securities and Assumption of)
10 Affiliated Interest.)

11 Springfield, Illinois
12 February 2, 2001

13 Met, pursuant to agreement, at 8:30 A.M.

14 BEFORE:

15 MR. WILLIAM SHOWTIS, Examiner

16 APPEARANCES:

17 MR. BOYD J. SPRINGER
18 MS. LIDIA FIORE
19 Jones, Day, Reavis & Pogue
20 77 West Wacker
21 Suite 3500
22 Chicago, Illinois 60601-1692

 (Appearing on behalf of
 Illinois-American Water Company)

 MS. SUE SCHULTZ
 Attorney at Law
 300 North Water Works Drive
 Belleville, Illinois 62223

 (Appearing on behalf of
 Illinois-American Water Company)

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1 PROCEEDINGS

2 EXAMINER SHOWTIS: Pursuant to the authority
3 vested in me by the Commission, I now call for
4 hearing Docket 00-0476 which concerns the petition
5 of Illinois-American Water Company, Citizens
6 Utilities Company of Illinois, and Citizens Lake
7 Water Company for approval of a proposed
8 reorganization and affiliated interest agreements,
9 issuance of common stock and debt securities, and
10 assumption of affiliated interest.

11 Will the parties please enter their
12 appearances for the record.

13 MR. SPRINGER: Boyd J. Springer and Lidia
14 Fiore of Jones, Day, Reavis & Pogue, 77 West
15 Wacker, Suite 3500, Chicago, Illinois 60601-1692,
16 appearing on behalf of Illinois-American Water
17 Company.

18 MS. SCHULTZ: Sue Schultz, General Counsel,
19 Illinois-American Water Company, also appearing on
20 behalf of Illinois-American. My business address
21 is 300 North Water Works Drive, Belleville,
22 Illinois 62223, and my telephone is (618)239-2225.

1 MICHAEL GORMAN
2 called as a witness on behalf of the Illinois
3 Industrial Water Consumers, having been first duly
4 sworn, was examined and testified as follows:

5 DIRECT EXAMINATION

6 BY MR. FITZHENRY:

7 Q. Mr. Gorman, would you please state your
8 full name and business address for the record?

9 THE WITNESS:

10 A. My name is Michael Gorman. My business
11 address is 1215 Fern Ridge Parkway, St. Louis,
12 Missouri.

13 Q. And on whose behalf are you testifying
14 in this proceeding?

15 A. Illinois Industrial Water Consumers.

16 Q. Mr. Gorman, I show you what's been
17 marked for identification as IIWC Exhibit 1.0
18 entitled Direct Testimony and Exhibit of Michael
19 Gorman and ask if this is your prefiled direct
20 testimony for submission in this proceeding?

21 A. It is.

22 Q. And does this exhibit consist of 16

1 pages of questions and answers and Appendix A,
2 pages 1 through 3, and Schedules 1 through 4?

3 A. Yes.

4 Q. Was this testimony and were these
5 exhibits prepared by you or under your direction
6 and supervision?

7 A. They were.

8 Q. Do you have any corrections or changes
9 to Exhibit 1.0 or the schedules attached?

10 A. I do not.

11 Q. If I were to ask you the questions that
12 are set forth in your prefiled testimony, would
13 your answers be as set forth therein?

14 A. Yes.

15 Q. I also show you what's been marked for
16 identification as IIWC Exhibit 2.0 entitled the
17 Rebuttal Testimony of Michael Gorman and ask if
18 this is your prefiled rebuttal testimony for
19 submission in this proceeding?

20 A. It is.

21 Q. And does IIWC Exhibit 2.0 consist of 23
22 pages of questions and answers?

1 A. Yes.

2 Q. Was the testimony prepared by or under
3 your direction and supervision?

4 A. Yes.

5 Q. If I were to ask you the questions set
6 forth in IIWC Exhibit 2.0, would your answers be as
7 set forth therein?

8 A. Yes.

9 Q. And did you have any corrections or
10 modifications to your prefiled rebuttal testimony?

11 A. No.

12 MR. FITZHENRY: Mr. Showtis, I move for the
13 admission of IIWC Exhibits 1.0 and 2.0, and
14 Mr. Gorman is available for cross-examination.

15 EXAMINER SHOWTIS: Any objection?

16 MR. SPRINGER: No objection.

17 EXAMINER SHOWTIS: IIWC Exhibits 1.0 and 2.0
18 are admitted into evidence.

19 (Whereupon IIWC Exhibits
20 1.0 and 2.0 were received
21 into evidence.)

22

1 CROSS EXAMINATION

2 BY MR. SPRINGER:

3 Q. Mr. Gorman, this is the first case in
4 which you sponsored testimony regarding a utility
5 reorganization as defined in Section 7-204 of the
6 Illinois Public Utilities Act. Is that correct?

7 A. That's correct.

8 Q. At the time you prepared your direct
9 testimony in this case, you reviewed the orders of
10 the Illinois Commerce Commission in Dockets 95-0551
11 and 99-0418. Is that correct?

12 A. I'm sorry. Could you repeat those
13 docket numbers again?

14 Q. Yes; 95-0551 and 99-0418.

15 A. Yes.

16 Q. You did not rely in preparing your
17 direct testimony on orders of regulatory
18 commissions from other jurisdictions in which
19 savings sharing proposals had been approved. Is
20 that correct?

21 A. Well, I didn't specifically review
22 orders from those other jurisdictions. I was

1 familiar with other proposals to recover merger and
2 acquisition costs in rates.

3 Q. So you are aware of orders from other
4 jurisdictions where savings sharing proposals have
5 been approved?

6 A. Yes.

7 Q. You do not list any of those orders in
8 your data response as being an order you relied on
9 in preparing your direct testimony though. Is that
10 correct?

11 A. Well, that is correct. The reason I
12 didn't list it I suppose is because I didn't
13 specifically review the order in developing my
14 testimony. I was generally familiar with the order
15 already, and that is the reason it wasn't listed in
16 that response.

17 Q. To the extent that Illinois-American
18 Water Company can produce savings by its
19 acquisition of CUCI by managing the system more
20 efficiently or producing economies of scale,
21 Illinois-American Water Company may be able to
22 produce savings that could not have been produced

1 absent the acquisition. Is that correct?

2 A. That is correct.

3 Q. In your view, the amount of an
4 acquisition premium, if any, that should be subject
5 to recovery through a rate plan should be the
6 amount of cost Illinois-American Water Company
7 incurred in order to realize acquisition savings.
8 Is that correct?

9 A. To the extent those costs produce
10 savings which more than cover that cost, yes.

11 Q. You believe that a properly estimated
12 acquisition premium may be subject to recovery
13 through rates if the utility demonstrates bona fide
14 savings that can only be produced by the
15 acquisition. Is that correct?

16 A. I believe that's correct. Could you
17 repeat that whole thing again?

18 Q. Sure. You believe that a properly
19 estimated acquisition premium may be subject to
20 recovery through rates if the utility demonstrates
21 bona fide savings that can only be produced by the
22 acquisition. Is that correct?

1 A. That is.

2 Q. If the savings are significant enough to
3 justify the cost, then the utility should be
4 allowed an opportunity to recover a properly
5 measured acquisition premium in rates. Is that
6 correct?

7 A. Yes. That's my position.

8 Q. In your rebuttal testimony at page 4,
9 beginning at line 10, you suggest there that in
10 future rate cases, nonacquisition-related
11 productivity gains could be included by the
12 Commission as demonstrated savings. Is that
13 correct?

14 A. That is -- I would not suggest that the
15 Commission would do that intentionally, but if non-
16 acquisition-related productivity gains were
17 included in demonstrated savings and the Commission
18 wasn't apprised that some of those savings
19 shouldn't be included in that, then yes, they could
20 be reflected in rates, and rates could be higher
21 than they otherwise would have been.

22 Q. All right. So you agree that the

1 Commission would not intentionally include non-
2 acquisition-related productivity gains as
3 demonstrated savings under the Savings Sharing
4 Proposal. Correct?

5 A. Yes, I agree with that.

6 Q. The risk then is that the Staff and/or
7 Intervenors in a future rate proceeding would not
8 properly apprise the Commission of the inclusion of
9 what you would feel to be nonacquisition savings
10 under the plan. Is that correct?

11 A. Yeah. That would be the customers' risk
12 under the Company's plan.

13 Q. In your rebuttal testimony at page 4,
14 beginning at line 10, you state: "Under the
15 Company's proposal, if nonacquisition-related
16 productivity gains are included as demonstrated
17 savings, then investors will retain a share of the
18 savings, and the customers' rates will be higher."
19 Is that correct?

20 A. Yes.

21 Q. You are not aware of any
22 Illinois-American Water Company testimony which

1 suggests that nonacquisition savings will be
2 included in the Savings Sharing Proposal. Is that
3 correct?

4 A. That is correct.

5 Q. Referring now to page 8 of your rebuttal
6 testimony at line 8, you refer to what you call
7 other points of distinction between the present
8 case and Dockets 98-0555 and 98-0866. Is that
9 correct?

10 A. Yes.

11 Q. And you do not have any listing of other
12 distinctions. Is that correct?

13 A. That's correct.

14 Q. You discuss the Commission's orders in
15 Docket 98-0555 and 98-0866 at the top of page 8 of
16 your rebuttal testimony. Is that correct?

17 A. Yes.

18 Q. You indicate there your belief that the
19 telephone companies' rates were based on an
20 alternative rate plan. Is that correct?

21 A. It is.

22 Q. And you believe that an alternative rate

1 plan was involved in both dockets, 98-0555 and
2 98-0866. Would that be your view?

3 A. That's my understanding, yes.

4 Q. Would you accept that the order in
5 Docket 98-0866 indicates that the utility involved
6 there was a rate of return regulated utility
7 subject to traditional ratemaking?

8 A. Are you asking me to accept that subject
9 to check?

10 Q. Yes.

11 A. Yes, I will.

12 Q. Have you read the order in Docket
13 98-0866?

14 A. I reviewed specific parts of it related
15 to treatment of merger savings. I did not review
16 the entire order, no.

17 Q. You believe the order in Docket 98-0555
18 involved a utility subject to an alternative rate
19 plan. Is that correct?

20 A. Yes.

21 Q. But you don't know whether or not the
22 rate setting methodology applicable to

1 Illinois-American Water Company is comparable to
2 the alternative rate plan used by that utility.
3 Correct?

4 A. I did not make that investigation.
5 Correct.

6 Q. At page 8 of your rebuttal testimony,
7 beginning at line 18, you say, "Net savings are a
8 portion of total savings that remain after IIWC
9 fully recovers the acquisition requirement. The
10 relevant question is the allocation of total
11 demonstrated savings." Is that your statement?

12 A. It is.

13 Q. There you are distinguishing total
14 savings from net savings. Is that correct?

15 A. Yes.

16 Q. Would you agree that at page 42 of the
17 order in Docket 98-0866 the Commission states: "To
18 the extent that costs are incurred to produce
19 savings and are shown to be both reasonable and
20 directly related, netting is appropriate as a
21 matter of logic. The only savings that can be
22 realized are net savings. Moreover, our reading of

1 Section 7-204(c) indicates that just such a result
2 is contemplated."

3 A. Did you ask me to accept that subject to
4 check?

5 Q. Yes.

6 A. Yes.

7 Q. Similarly, the order in Docket 98 -0555
8 states: "As a matter of logic, the only savings
9 that can be experienced are net savings." Would
10 you accept that subject to check?

11 A. Yes.

12 EXAMINER SHOWTIS: Did you have a page
13 reference for that second cite?

14 MR. SPRINGER: I can provide one,
15 Mr. Examiner. I have the order.

16 EXAMINER SHOWTIS: That's a rather voluminous
17 order, so if you could just provide a page
18 reference for the cite.

19 MR. SPRINGER: Yes, I will do that. If I can
20 do that at the conclusion of the questioning.

21 EXAMINER SHOWTIS: That's fine.

22 MR. SPRINGER:

1 Q. You believe it would be reasonable to
2 consider a rate plan that provides for an
3 opportunity for the Company to recover a control
4 premium for an investment made above prevailing
5 market price if the control premium produced
6 savings that justified the above-the-market price
7 investment. Is that correct?

8 A. I'm sorry, Boyd. Could you read that
9 back one more time, please?

10 Q. Sure. You believe it would be
11 reasonable to consider a rate plan that provides
12 for an opportunity for the Company to recover a
13 control premium for an investment made above
14 prevailing market price if the control premium
15 produced savings that justify the above-the-market
16 price investment. Is that correct?

17 A. That is, yes.

18 Q. At page 17 of your rebuttal testimony,
19 beginning at line 3, you state: "Mr. Stafford's
20 contention that originally estimated demonstrated
21 savings will continue into perpetuity is without
22 factual foundation and contrary to Mr. Stafford's

1 own testimony." Is that correct?

2 A. Page 17?

3 Q. Right, at line 3.

4 A. Yes.

5 Q. And there you refer to Mr. Stafford's
6 testimony on rebuttal, Exhibit 3.0R, page 2, lines
7 6 to 18. Is that correct?

8 A. I provided the reference to that in a
9 data response. I don't have that in the testimony.

10 Q. Would you accept that the reference
11 you've provided is the one I stated? Your data
12 response to the Second Data Request No. 15.

13 A. Page 2, lines 6 --

14 Q. 6 through 18.

15 A. 6 through 18, yes. Yes.

16 Q. At that page of his testimony
17 Mr. Stafford discusses the demonstration of savings
18 at the time of each future rate proceeding during
19 the 40-year period of the savings sharing plan.
20 Would that be right?

21 A. Yes.

22 Q. Mr. Stafford points out that no

1 allocation of savings to shareholders is made
2 unless at the time of the rate case the Company is
3 able to demonstrate to the Commission that savings
4 resulting from the acquisition are reflected in the
5 test year. Is that correct?

6 A. No allocation to shareholders?

7 Q. Yes.

8 A. Could you read that back again, please?

9 Q. Yes. Mr. Stafford points out that no
10 allocation of savings to shareholders is made
11 unless at the time of the rate case the Company is
12 able to demonstrate to the Commission that savings
13 resulting from the acquisition are reflected in the
14 test year. Is that correct?

15 MR. FITZHENRY: Could I show Mr. Gorman a copy
16 of Mr. Stafford's testimony if you're going to
17 continually ask him whether that's represented in
18 his testimony?

19 MR. SPRINGER: That's fine with me.

20 MR. FITZHENRY: It might be easier.

21 (Whereupon said document
22 was provided to the witness

1 by Mr. Fitzhenry.)

2 Q. That statement begins at line 12.

3 A. Yeah, that sentence is there, yes.

4 Q. And Mr. Stafford doesn't say anything in
5 this testimony that you reference about savings
6 continuing into perpetuity, does he?

7 A. The question was whether or not -- at
8 this point in his testimony he suggests that, in
9 agreement with Ms. Everson, that it is certainly
10 correct in suggesting that the timing and the
11 amount of savings may vary over the 40-year
12 amortization period. Later in his testimony I
13 believe he does state that savings will continue --

14 Q. Mr. Gorman, I'm just asking you about
15 the testimony you cited in the data response as
16 being the testimony you discussed at page 17, lines
17 4 and 5 of your testimony, where you state that --

18 A. In response to that data request, you
19 asked me to cite support for my contention that
20 Mr. Stafford offered evidence that the savings
21 would not continue into perpetuity, and in support
22 of that statement I referred you to page 2 of his

1 rebuttal testimony where he said that it is correct
2 to suggest that timing and the amount of savings
3 may vary over a 40-year period.

4 Q. All right. Do you see a statement in
5 the portion of the testimony you cite that states
6 that savings will continue into perpetuity?

7 A. Are you asking me where in
8 Mr. Stafford's testimony he makes that statement?

9 Q. No. I'm asking about the testimony
10 cited in response to question 15 of the Second Data
11 Request.

12 A. At that part of his testimony he doesn't
13 make that statement.

14 Q. Thank you.

15 MR. SPRINGER: That's all the questions I have
16 for Mr. Gorman.

17 EXAMINER SHOWTIS: I have some questions.

18 EXAMINATION

19 BY EXAMINER SHOWTIS:

20 Q. One of your criticisms of the SSP
21 proposed by the Applicants is the 40-year period,
22 and you make various comments that it's speculative

1 to attempt to estimate demonstrated savings several
2 years after an acquisition takes place. Do you
3 believe that savings can be tracked over some
4 shorter period, or do you believe it's impossible
5 to ever track demonstrated savings associated with
6 an acquisition or merger?

7 A. In either case, I think the estimate of
8 savings is going to be an estimate, much like a
9 forecasted test year. The shorter the period in
10 which you're forecasting, the more reliable your
11 forecast will be. Consequently, I believe a
12 shorter period of time which a rate plan is devised
13 which allows an opportunity to recover acquisition
14 cost, be it estimated acquisition savings, is more
15 likely to not create detrimental rate impacts for
16 customers.

17 Q. By that answer are you indicating that
18 tracking of savings over a shorter period is
19 possible?

20 A. Yes, it is possible. I think the issue
21 I'm trying to raise is the degree of reliability of
22 your estimated savings to truly represent actual

1 savings.

2 Q. Well, the Commission has entered two
3 orders, the SBC/Ameritech merger order and the GTE/
4 Bell Atlantic merger order, that are referenced in
5 your testimony that does provide for some sharing
6 of savings; I believe a 50/50 sharing of some
7 savings after some netting of certain costs. Is
8 that correct?

9 A. Certain costs. I don't believe an
10 acquisition adjustment was amongst those costs, but
11 that is correct.

12 Q. That's correct. There wasn't an
13 acquisition premium in those cases, but if the
14 Commission has allowed sharing, there would have to
15 be some way to determine what is being shared.
16 Isn't that correct?

17 A. That's correct, and I would suggest that
18 the proper way of determining what you're sharing
19 is to measure what customers are giving up. Under
20 the normal or traditional method of setting rates,
21 all productivity gains and cost reductions are
22 passed on to customers via lower rates. Under the

1 Company's proposal, they would like to retain
2 certain savings that are produced by virtue of the
3 acquisition in order to allow them an opportunity
4 to recover their cost of producing those savings.
5 So from the customers' standpoint, in order to
6 measure the benefits of the acquisition we have to
7 look at what we're giving up in order to get
8 savings.

9 Q. Is one of the problems that you believe
10 is associated with the proposal of the Applicants
11 the size of the acquisition adjustment or premium?

12 A. Yes, in relationship to the estimated
13 savings, yes.

14 Q. If you were to prioritize your concerns,
15 that is put them in order in terms of what you
16 believe is the greatest problem with the proposal,
17 what would be the largest problem with the
18 proposal? And I'm talking about comparing the
19 40-year period to the size of the acquisition
20 premium and any other components.

21 A. Those are my two largest concerns with
22 the proposal. A 40-year period is much too long to

1 disturb the traditional cost-of-service
2 methodologies that establish rates, in my judgment.

3 Second, their proposal to recover the
4 entire difference between the acquisition price and
5 book value through rates overcompensates the
6 Company relative to the compensation other
7 investors get by making purchases of utility stock
8 or plant.

9 Q. If there were a plan that was adopted by
10 the Commission that approved some sort of sharing
11 of savings in this case, what do you believe would
12 be the longest period over which the plan should be
13 in effect?

14 A. In my judgment --

15 Q. And this would also, obviously, have to
16 involve some sort of tracking of savings if there
17 were to be a sharing, I would assume.

18 A. If it was a shared savings methodology,
19 it would. In my judgment, a ten-year period is
20 consistent with many rate plans to provide recovery
21 of mergers and acquisition costs. Based on my
22 review of the Company's filing, I believe it is an

1 adequate period of time to provide them an
2 opportunity to recover the true cost it is
3 incurring to realize their estimated acquisition
4 savings.

5 Q. In terms of the impact on ratepayers,
6 which do you believe has the most adverse effect,
7 the SSP or the alternative proposal?

8 A. I think it's a degree of risk customers
9 assume, and from a customer standpoint, I think
10 they're probably pretty comparable. In both cases
11 demonstrated savings have to be made over a 40-year
12 period. An allocation of the savings and the costs
13 have to be made in the same way in order to prevent
14 negative rate impact. Under both methodologies, if
15 the Company is not able to prove demonstrated
16 savings per the Company's testimony and they are
17 not able to recover the acquisition premium, there
18 may be a financial impairment to the Company. The
19 Company has stated that they would not attempt to
20 recover higher capital costs if that were the case
21 in rates, but there is an uncertainty about whether
22 or not the Company, if they truly mean that, would

1 be able to follow through with it later if both not
2 recovering the acquisition adjustment and also not
3 recovering higher capital costs would put them in a
4 financial position where they may not be able to
5 provide high quality, reliable service. I see that
6 as a risk in both plans.

7 I guess from IAWC's standpoint, the
8 shared savings plan is more of a risk because IAWC
9 customers have very little estimated benefits under
10 this plan, but yet they would be subject to the
11 regulatory uncertainty of the SSP over the next 40
12 years. So from IAWC's customers' standpoint, the
13 alternative regulatory plan would be preferential.

14 Q. Do you believe that the adoption of
15 either the SSP or the alternative proposal could
16 result in an increase in rates for the CUCI service
17 territory which would be above the rates that would
18 exist if CUCI remained a stand-alone company?

19 A. I think there is a risk that that could
20 happen, yes.

21 Q. And what is the primary factor driving
22 that risk? Is that the problems with estimating

1 the savings or is that something else?

2 A. Problems of estimating the savings is a
3 very significant problem in the Company's plan. As
4 I understand the proposal, the Company will use its
5 judgment to best estimate the savings that can be
6 created as a result of the acquisition. In order
7 to make those savings estimates you have to be
8 intimately familiar with the operations of both
9 water utilities, IIWC and CUCI.

10 At the time of the next rate filing the
11 Staff and Intervenors will be put in the position
12 to evaluate the manpower requirements of the merged
13 company and the manpower requirements of the two
14 companies as though they had not merged. That's
15 going to be a difficult evaluation for an
16 Intervenor and, based on my experience, for a Staff
17 witness as well. We are going to be highly
18 dependent on the Company's judgment on those
19 factors. It's going to be difficult for us to
20 respond or to rebut the Company's opinion on the
21 manpower requirements.

22 A similar rate case issue, to draw an

1 analogy, is vacancy positions from a historical
2 year to a forecasted year. The Company could
3 maintain in a rate proceeding that while they have
4 40 vacant positions with authority to fill them,
5 that's what exists in the historical year, they
6 plan on filling 20 of those positions by the
7 forecasted year. It's difficult for a Staff or an
8 Intervenor witness to argue that maybe you will
9 fill those positions; maybe you won't. The costs
10 might be there; the costs might not be there.
11 Demonstrated savings will require similar
12 adjustments which will be based on nothing more
13 than the judgment of a Staff analyst, an Intervenor
14 analyst, as opposed to the Company. I mean it will
15 be more complicated.

16 The types of evaluations I can envision
17 are comparing the Company's estimated demonstrated
18 savings to savings that could be produced on the
19 companies on a stand-alone basis. That might
20 entail evaluating the Company's ability to
21 outsource human resources accounting functions to
22 reduce those costs of CUCI even if CUCI wasn't

1 acquired by IAWC. If IAWC's personnel are at a
2 higher pay scale than what CUCI's personnel might
3 have been absent the acquisition, then we would
4 have to identify that and prove it to reduce the
5 amount of demonstrated savings.

6 If there's new technology which is
7 introduced in the water industry which reduces
8 operating costs of distribution, production, and
9 customer functions of the utility, the Staff and
10 Intervenors will have to draw upon some expertise
11 to rebut the Company's contention of estimated or
12 demonstrated savings in those areas. It's going to
13 be very difficult to respond to the Company's
14 opinions and judgments on those issues.

15 EXAMINER SHOWTIS: That's all I had.

16 MR. FITZHENRY: Could we have a 45 -minute
17 break?

18 (Laughter)

19 EXAMINER SHOWTIS: You've got one minute.

20 (Whereupon a short recess
21 was taken.)

22 MR. FITZHENRY: We don't have any redirect.

1 EXAMINER SHOWTIS: You can step down.

2 (Witness excused.)

3 MARY H. EVERSON

4 called as a witness on behalf of the Staff of the
5 Illinois Commerce Commission, having been first
6 duly sworn, was examined and testified as follows:

7 DIRECT EXAMINATION

8 BY MS. VON QUALEN:

9 Q. Please state your full name for the
10 record.

11 THE WITNESS:

12 A. My name is Mary H. Everson.

13 Q. Who is your employer and what is your
14 business address?

15 A. I'm employed by the Illinois Commerce
16 Commission. My business address is 527 East
17 Capitol Avenue, Springfield, Illinois 62701.

18 Q. What is your position at the Commission?

19 A. I'm a Staff Accountant.

20 Q. Ms. Everson, did you prepare written
21 exhibits and schedules for submittal in this
22 proceeding?

1 A. I did.

2 Q. Do you have before you ICC Staff Exhibit
3 2.0 entitled Direct Testimony of Mary H. Everson?

4 A. Yes.

5 Q. Which consists of 14 typewritten pages
6 and one schedule?

7 A. Yes.

8 Q. Did you prepare that document for
9 presentation in this matter?

10 A. Yes, I did.

11 Q. Do you have any additions or corrections
12 to make to ICC Staff Exhibit 2?

13 A. No.

14 Q. Do you also have before you a document
15 which has been marked as ICC Staff Exhibit 8.0,
16 Rebuttal Testimony of Mary H. Everson?

17 A. Yes.

18 Q. And did you also prepare that document
19 for this proceeding?

20 A. Yes, I did.

21 Q. Do you have any additions or corrections
22 to make to ICC Staff Exhibit 8.0?

1 A. No.

2 Q. Is the information contained in ICC
3 Exhibits 2.0 and 8.0 true and correct to the best
4 of your knowledge?

5 A. Yes.

6 Q. If I asked you the same questions as
7 those set forth in those exhibits, would your
8 answers be the same today?

9 A. Yes, they would.

10 MS. VON QUALEN: At this time, Mr. Examiner, I
11 move for admission into evidence of Staff Exhibits
12 2.0 and 8.0.

13 EXAMINER SHOWTIS: Is there any objection?

14 MR. SPRINGER: No objection.

15 EXAMINER SHOWTIS: Staff Exhibits 2.0 and 8.0
16 are admitted into evidence.

17 (Whereupon ICC Staff
18 Exhibits 2.0 and 8.0 were
19 received into evidence.)

20 MS. VON QUALEN: Ms. Everson is available for
21 cross-examination.

22 EXAMINER SHOWTIS: Mr. Springer.

1 MR. SPRINGER: Thank you.

2 CROSS EXAMINATION

3 BY MR. SPRINGER:

4 Q. Ms. Everson, you have not previously
5 testified with regard to a utility reorganiz ation
6 as defined in Section 7-204 of the Illinois Public
7 Utilities Act. Is that correct?

8 A. That's correct.

9 Q. In your direct testimony at page 3,
10 beginning at 50, you state IAWC refers to its
11 projections of expected cost savings as
12 demonstrated savings. Is that correct?

13 A. Yes.

14 Q. This testimony is not a direct quote of
15 any specific Company statement. Is that correct?

16 A. No, it is not.

17 Q. In fact, the term "demonstrated savings"
18 is defined by the Company as acquisition savings
19 shown by the Company to be included in data for
20 each rate case test year. Is that correct?

21 A. Can you show me -- tell me where that
22 is?

1 Q. Yes. That is at the direct testimony of
2 Mr. Stafford, page 4, line 17. It was also
3 referenced in your Data Response No. 36.

4 A. Can you ask me the question again?

5 Q. Yes. In fact, the term "demonstrated
6 savings" is defined by the Company as acquisition
7 savings shown by the Company to be included in data
8 for each rate case test year. Is that correct?

9 A. Yes.

10 Q. Would you also accept that at Exhibit
11 3.0, which is Mr. Stafford's direct testimony, page
12 2, Mr. Stafford refers to acquisition savings, and
13 this begins at line 23, as significant economies
14 and efficiencies which will result in a reduced
15 level of cost as compared to the level which would
16 exist for the separate companies on an aggregate
17 basis?

18 A. That is what Mr. Stafford says.

19 Q. Going back now to your direct testimony,
20 page 3, beginning at line 51, you say, "According
21 to the Company, the projections of expected cost
22 savings are the amounts which are to be shared

1 between the ratepayers and shareholders." Is that
2 correct?

3 A. Yes.

4 Q. This also is not a direct quote of any
5 specific Company statement. Is that correct?

6 A. That's correct.

7 Q. At page 3, beginning at line 54, you
8 say, "The projections of expected cost savings are
9 first reduced -- excuse me. I'll start over.

10 At page 3, beginning at line 54, you
11 state, "The projections of expected cost savings
12 are first reduced by 10 percent, which the Company
13 says is benefiting ratepayers, even though the
14 nature of the benefit is unclear." Again, this is
15 not a direct quote of any specific Company
16 statement. Is that correct?

17 A. That's correct.

18 Q. At page 5 of your direct testimony,
19 beginning at line 89, you indicate your belief that
20 it is inappropriate to project conditions over a
21 40-year period. Is that correct?

22 A. I describe in that section of my

1 testimony that the uncertainty increases over time
2 due to the 40-year period.

3 Q. You are not aware of specific studies or
4 authorities which support your position. Is that
5 correct?

6 A. I did not review any studies.

7 Q. At page 6 of your direct testimony,
8 beginning at line 112, and continuing through page
9 7 at line 132, you discuss your concerns with the
10 home mortgage method of amortization. Is that
11 correct?

12 A. That's correct.

13 Q. As a practical matter, many amortization
14 methods exist and are acceptable for accounting
15 purposes. Is that correct?

16 A. That's correct.

17 Q. You have not developed any alternative
18 to the home mortgage method of amortization. Is
19 that correct?

20 A. In this section I'm merely informing the
21 Commission of the effect. I'm not recommending an
22 alternative method.

1 Q. Using the home mortgage method, the
2 amortization in the early years is smaller than it
3 would be under a straight line method. Is that
4 correct?

5 A. Yes, I believe that would be correct.

6 Q. You have not characterized the home
7 mortgage method of amortization as being incorrect.
8 Is that a correct statement?

9 A. That's a correct statement.

10 Q. In your direct testimony at page 7,
11 beginning at line 130, you state: "In addition,
12 IAWC is not proposing an immediate reduction of
13 revenue to reflect the reduced costs." Is that
14 correct?

15 A. That's correct.

16 Q. You have no idea if Illinois American's
17 rates properly reflect the current or future
18 revenue requirements of the utility's operations.
19 Is that correct?

20 A. Would you read that to me again?

21 Q. Yes. The question is, you have no idea
22 if Illinois American's rates properly reflect the

1 current and future revenue requirements of the
2 utility's operations. Is that correct?

3 A. Well, I haven't worked on one of their
4 rate cases, so, no, I don't have any knowledge at
5 the moment.

6 Q. Therefore, you do not know whether a
7 rate filing for one or more service areas is
8 presently appropriate or required to reflect
9 acquisition savings. Is that correct?

10 A. That's correct.

11 Q. Beginning at page 8, line 146, you
12 discuss your position regarding contributions and
13 advances. Is that correct?

14 A. I have line 148, but, yes, I see the
15 paragraph.

16 Q. You do not rely on any regulatory
17 commission order to support your position
18 concerning contributions in aid of construction and
19 advances. Is that correct?

20 A. I rely on Accounting Instruction 21 for
21 the Uniform System of Accounts, not a Commission
22 order.

1 Q. I'm sorry. What was the last part of
2 your answer?

3 A. Not on a Commission order.

4 Q. Turning to your rebuttal testimony at
5 page 5, beginning at line 107, you state: "The
6 savings that the Company --

7 A. Excuse me. Page 5?

8 Q. Yes, of your rebuttal testimony.

9 A. Page 5 only goes to line 101, so.

10 Q. Mine goes to line 109. Let me show you
11 the statement.

12 A. Fine.

13 Q. Apparently we have a different page 6.

14 A. Right. Where?

15 Q. I'll start my question again. At page 5
16 of your rebuttal testimony, beginning at line 107,
17 you state: "The savings that the Company claims it
18 can prove simply will not be verifiable in a year
19 other than the one in which the savings actually
20 occur." Is that correct?

21 A. I see that, yes.

22 Q. You do not rely on any specific study or

1 analysis that you prepared for this case to support
2 the statement. Is that correct?

3 A. I'm not relying on a specific study for
4 that.

5 MR. SPRINGER: Thank you. I have nothing
6 further for Ms. Everson.

7 MR. FITZHENRY: I have no questions.

8 EXAMINER SHOWTIS: I just had a couple
9 questions.

10 EXAMINATION

11 BY EXAMINER SHOWTIS:

12 Q. One of your concerns with the Company's
13 Savings Sharing Proposal is the 40-year period. Is
14 that correct?

15 A. That's correct.

16 Q. Do you believe that it is possible to
17 track savings over a shorter period?

18 A. I can't say that I have tried to decide
19 whether that would be possible. I've considered
20 the tracking of savings within the context of a
21 rate proceeding, and I believe it would be
22 extremely difficult to do.

1 Q. Are you aware that in two merger
2 proceedings involving Ameritech and SBC and GTE and
3 Bell Atlantic that the Commission decided that net
4 savings determined in those cases should be shared
5 50/50 between shareholders and ratepayers?

6 A. I'm familiar that there is to be a
7 determination of savings as a result of those
8 orders.

9 Q. Would you assume that in order to
10 implement those conclusions there would have to be
11 some sort of determination of what those savings
12 are?

13 A. Yes.

14 Q. And just to follow up on one of
15 Mr. Springer's questions, you criticized the home
16 mortgage amortization method, but you're not
17 proposing an alternative amortization method. Is
18 that correct?

19 A. That's correct. I'm just informing the
20 Commission of the effect of the choice of that
21 method.

22 EXAMINER SHOWTIS: Okay. That's all I had.

1 MS. VON QUALEN: Could we have a brief recess?

2 EXAMINER SHOWTIS: Yes.

3 (Whereupon a short recess

4 was taken.)

5 EXAMINER SHOWTIS: Back on the record.

6 Staff had no redirect examination of

7 Ms. Everson.

8 (Witness excused.)

9 MR. SPRINGER: Mr. Examiner, I'd like to
10 provide that page number you requested in the order
11 in the Ameritech/SBC case, Docket 98-0555. The
12 page number is 150.

13 EXAMINER SHOWTIS: Okay.

14 MS. VON QUALEN: Staff calls Ron King.

15 (Whereupon ICC Staff

16 Exhibit 12.0 Revised was

17 marked for identification.)

18

19

20

21

22

1 ROY A. KING

2 called as a witness on behalf of the Staff of the
3 Illinois Commerce Commission, subsequently in the
4 proceeding been duly sworn, was examined and
5 testified as follows:

6 DIRECT EXAMINATION

7 BY MS. VON QUALEN:

8 Q. Good morning, Roy. Please state your
9 full name for the record.

10 THE WITNESS:

11 A. Roy A. King.

12 Q. Who is your employer and what is your
13 business address?

14 A. I'm employed by the Illinois Commerce
15 Commission. My business address is 527 East
16 Capitol Avenue, Springfield, Illinois 62701.

17 Q. What is your position?

18 A. I'm an Economic Analyst in the Water
19 Department.

20 Q. Did you prepare written exhibits for
21 submittal in this proceeding?

22 A. Yes, I did.

1 Q. Do you have before you a document
2 entitled ICC Staff Exhibit 6, Direct Testimony of
3 Roy A. King?

4 A. Yes, I do.

5 Q. Which consists of seven typewritten
6 pages?

7 A. That is correct.

8 Q. Did you prepare that document for
9 presentation in this matter?

10 A. Yes.

11 Q. Do you have any corrections or additions
12 to make?

13 A. No.

14 Q. Do you also have before you a document
15 which has been marked as ICC Staff Exhibit 12.0,
16 Rebuttal Testimony of Roy A. King?

17 A. Yes.

18 Q. Did you also prepare that document for
19 presentation in this matter?

20 A. Yes, I did.

21 Q. And I understand you prefiled a copy of
22 your rebuttal testimony. Do you have any changes

1 or corrections to make to the prefiled testimony?

2 A. Yes. On page 5 I have two corrections.

3 Q. And what are those?

4 A. On line 110, (f), the docket number
5 should be 95-0537 instead of 98-0537.

6 Q. All right.

7 A. On line 113 -- excuse me -- 115, the
8 docket number should be 93-0122 instead of 93-0121.

9 Q. And have you provided a copy of the
10 corrected testimony to the Court Reporter?

11 A. Yes, I have.

12 Q. Is the information contained in ICC
13 Exhibit 6.0 and 12.0 true and correct to the best
14 of your knowledge?

15 A. Yes.

16 Q. If I were to ask you the same questions
17 today, would your answers be the same?

18 A. Yes.

19 MS. VON QUALEN: At this time I ask for
20 admission into evidence of ICC Staff Exhibit 6.0
21 and ICC Staff Exhibit 12.0.

22 EXAMINER SHOWTIS: Is there any objection?

1 MR. SPRINGER: No objection.

2 EXAMINER SHOWTIS: Those two exhibits are
3 admitted, and the Court Reporter will mark the copy
4 of ICC Staff Exhibit 12.0 since it does vary from
5 the version that is on e-Docket. We can call that
6 then ICC Staff Exhibit 12.0 Revised since it is
7 revised from the version that was originally served
8 on the parties. So then ICC Staff Exhibit 6.0 and
9 12.0 Revised are admitted.

10 (Whereupon ICC Staff
11 Exhibits 6.0 and 12.0
12 Revised were received into
13 evidence.)

14 MS. VON QUALEN: Mr. King is available for
15 cross-examination.

16 CROSS EXAMINATION

17 BY MR. SPRINGER:

18 Q. Good morning, Mr. King.

19 A. Good morning.

20 Q. Mr. King, in developing your direct
21 testimony, you relied on no specific studies,
22 analyses, workpapers, or other documents. Is that

1 correct?

2 A. I believe I did not utilize any specific
3 documents in developing my direct testimony.

4 Q. And you yourself conducted no study or
5 analysis specifically for this case. Is that
6 correct?

7 A. Not specifically for this case, no.

8 Q. In your rebuttal testimony at page 8,
9 beginning at line 180, you state that, in your
10 opinion, it appears that if the Citizens
11 Telecommunications Company and CUCI allow service
12 to deteriorate due to the focus being on
13 telecommunications, then the operation of the water
14 and/or sewer would be contrary to Section 8-101,
15 paragraph 1, of the Public Utilities Act. Is that
16 correct?

17 A. That is correct.

18 Q. I take it your belief is that due to the
19 provisions of Section 8-101, the Commission need
20 not be concerned about a potential deterioration of
21 service?

22 A. In the years of experience that I have

1 had with Citizens since I have been in the Water
2 Department, I believe that is a correct answer.

3 Q. Also in your rebuttal testimony,
4 beginning at page 2, line 26, you discuss some
5 utilities who you say ignored the rules and
6 regulations of the state governing agencies which
7 have water quality problems, inadequate service,
8 and/or financial instability. Is that correct?

9 A. That is correct.

10 Q. And you indicate on page 2 that these
11 utilities have created problems for the Commission
12 Staff and customers. Is that correct?

13 A. That is correct.

14 Q. You also refer to some other utilities
15 that you believe are able to comply with state
16 laws. Is that correct?

17 A. That is correct.

18 Q. Now referring to the first group, that
19 being the utilities that have created problems for
20 the Commission and that have provided inadequate
21 service, can you identify for me utilities that you
22 are aware of that you would classify in that

1 category?

2 A. Well, one was pointed out in Mr. Love's
3 testimony. On page 4 he mentions the five
4 utilities up in McHenry that is owned by T. P.
5 Matthews. Another one was located in and around
6 Crete called Utilities Unlimited.

7 MS. VON QUALEN: Could you spell Crete?

8 A. C-R-E-T-E.

9 EXAMINER SHOWTIS: And just so the record is
10 clear, I believe Mr. Love did not end up testifying
11 in this case. Mr. Townsley presented testimony
12 which except for some minor changes, which
13 reflected his position and experience, was more or
14 less identical to Mr. Love's testimony.

15 Q. The utilities you reference, Mr. King,
16 are subject to the provisions of the Public
17 Utilities Act, are they not?

18 A. That is correct.

19 Q. And that would include Section 8 -101 of
20 the Act?

21 A. Yes.

22 Q. Would that also include the obligations

1 set forth in Section 8-401 of the Act to provide
2 service and facilities which are in all respects
3 adequate, efficient, reliable, environmentally
4 safe, and which consistent with these obligations
5 constitute the least cost means of meeting utility
6 service obligation?

7 A. Yes.

8 Q. The utilities you reference would also
9 be subject to 83 Illinois Administrative Code 600,
10 the Commission's standards of service for water
11 utilities. Is that correct?

12 A. That is correct.

13 Q. So it's not necessarily the case that
14 the mere existence of statutes and rules ensures
15 that adequate service will be provided, is it?

16 A. That is correct.

17 Q. Despite the applicability of the
18 provisions of the Public Utilities Act and
19 Commission rules, there can be utilities with water
20 quality problems, inadequate service, and financial
21 instability. Correct?

22 A. That is correct.

1 Q. Do you recall testifying, Mr. King, in
2 Docket 98-0753 which involved a request by
3 Consumers Illinois Water Company to seek a
4 certificate for an area called Calumet Gardens
5 served by the utility you referenced, Utilities
6 Unlimited?

7 A. Yes.

8 Q. Utilities Unlimited is a water and sewer
9 utility. Is that correct?

10 A. That's incorrect. At the time of the
11 filing of the testimony there was a Utilities
12 Unlimited. Since that time the Commission has
13 revoked or cancelled the certificate, and the area
14 is now being served by Consumers.

15 Q. All right. At one time in the past
16 Utilities Unlimited was a water and sewer utility.
17 Would that be correct?

18 A. That is correct.

19 Q. At the time that it was a water and
20 sewer utility, Utilities Unlimited was subject to
21 Section 8-101 of the Act, which you reference in
22 your rebuttal testimony at page 8. Is that

1 correct?

2 A. That is correct.

3 Q. It was also subject to Section 8-401 of
4 the Act. Is that correct?

5 A. That's correct.

6 Q. Would you accept that in Docket 98-0753
7 you submitted in evidence a Staff report concerning
8 Utilities Unlimited which was prepared by you?

9 A. Yes, I submitted a Staff report.

10 Q. You indicated -- would you accept that
11 in that report you indicated that, in your view,
12 Utilities Unlimited had failed to receive approval
13 for certain rates as required by Sections 9-104 and
14 9-241 of the Act?

15 A. That is correct.

16 Q. You also indicated that, in your view,
17 Utilities Unlimited had violated Section 83
18 Illinois Administrative Code Part 600.400 regarding
19 sale of water and Part 600.370(c)(1) requiring that
20 the utility furnish, install, and maintain at its
21 expense the permanent service connection meter and
22 other appliance necessary to deliver and measure

1 water furnished?

2 A. That is correct.

3 Q. You also testified to violations of 83

4 Illinois Administrative Code Part 280.90(d)

5 regarding late payment fees?

6 A. Yes.

7 Q. You testified to noncompliance with

8 Section 600.230 of the Commission's rules regarding

9 adequacy of service. Is that correct?

10 A. Yes.

11 Q. And this was because the system was

12 operating with only one well. Is that correct?

13 A. That is correct.

14 Q. You stated in the Staff report

15 "Utilities Unlimited has not complied with Section

16 8-101, paragraph 1." Is that correct?

17 A. Without having the report in front of

18 me, I would say subject to check, yes.

19 Q. Would you also accept that you stated

20 that Utilities Unlimited failed to comply with 83

21 Illinois Administrative Code Part 600, Section 210?

22 A. That is correct.

1 Q. Would you accept that you further stated
2 that due to numerous and continuing violations of
3 the Act and Commission regulations, Staff
4 recommends that the Commission issue a citation
5 order to initiate a formal proceeding?

6 A. That is correct.

7 Q. The mere existence of a statute or rule
8 requiring adequate service doesn't necessarily
9 indicate that adequate service will be provided.
10 Correct?

11 A. That is correct.

12 Q. Now on some occasions the Staff of the
13 Commission has also addressed service quality
14 issues concerning large utilities. Would that be
15 correct?

16 A. Yes.

17 Q. Would you accept that in Docket 92-0448,
18 for example, the Commission addressed a price
19 regulation formula for Illinois Bell Telephone
20 Company?

21 A. I didn't work the telephone so I can't
22 say.

1 Q. So you don't know whether in that case
2 Staff indicated that the price regulation formula
3 for that Company should include a service quality
4 component?

5 MS. VON QUALEN: I object to that question.
6 The witness has already indicated that he doesn't
7 know about that particular docket.

8 MR. SPRINGER: If the witness doesn't know
9 what I asked him, he can so indicate.

10 EXAMINER SHOWTIS: You can answer, and your
11 answer can be you don't know.

12 A. I don't know.

13 MR. SPRINGER: That's all the questions I have
14 for Mr. King.

15 EXAMINER SHOWTIS: Do you have questions?

16 MR. FITZHENRY: No, I have no questions for
17 Mr. King.

18 EXAMINATION

19 BY EXAMINER SHOWTIS:

20 Q. Do you know if Staff has in the past
21 raised service quality issues in Commission
22 proceedings that involve Citizens Utilities

1 Company?

2 A. I believe -- I'm not sure I will be
3 answering your question correctly. Some time back
4 in the late '70s, early '80s, Citizens Utility
5 Company had sought a rate increase from the
6 Commission, and at that time customers in North
7 Suburban area had indicated that they had quality
8 -- water quality problems and other problems, and
9 at that time the Commission entered an order not
10 granting a rate increase because of the quality
11 problems raised, and since then, working with
12 Citizens and everything else, they have tried to
13 minimize any type of complaints and work with the
14 Commission Staff, and since then I don't recall any
15 type of issue raised.

16 EXAMINER SHOWTIS: That's all I had.

17 MR. CLENNON: Could we just have a few
18 minutes?

19 EXAMINER SHOWTIS: Okay.

20 (Whereupon a short recess
21 was taken.)

22 EXAMINER SHOWTIS: Back on the record.

1 MS. VON QUALEN: Staff has a few questions.

2 REDIRECT EXAMINATION

3 BY MS. VON QUALEN:

4 Q. Mr. King, do you recall the questions
5 from Mr. Springer regarding Utilities Unlimited in
6 Docket 98-0753?

7 A. Yes, I do.

8 Q. Were there any unusual activities in
9 that docket that Mr. Springer did not ask you
10 about?

11 A. Yes. One of the things -- several of
12 the things that brought that docket to a head, in
13 front of the Commission, was, one, Mr. Petreikis --

14 EXAMINER SHOWTIS: You might have to --
15 probably the Reporter wouldn't know how to spell
16 that, so you might have to spell that.

17 MR. CLENNON: We will get the Reporter the
18 spelling.

19 A. Mr. Petreikis claimed one of the reasons
20 for his financial status was that the FBI had come
21 out into the service area and dug up the service
22 area, crushing sewer mains and stuff, looking for

1 bodies that were buried there because of the Mafia.

2 EPA found and there is court proceedings
3 going on that Mr. Petreikis, due to his sewage
4 treatment plant not operating correctly, was
5 dumping raw sewage into the receiving stream.

6 A customer who called me at 6:00 in the
7 morning complained that Mr. Petreikis had gone out
8 and shut off their water service around 2 o'clock
9 in the morning, and that was unique because trying
10 to explain to your wife at 6 o'clock in the morning
11 why a young girl is talking to you.

12 Mr. Petreikis would use his son as a
13 bill collector. One of the customers reported to
14 us in a meeting that his son had drove up on a
15 motorcycle carrying a weapon and exposing himself
16 to read the meter.

17 Also, during one of my inspections of
18 the sewer plant I found that there was a small
19 mobile trailer next to the sewer plant with the
20 electric cord run into the sewer plant and a grill
21 next or within 3 feet of the sewage plant,
22 indicating that somebody was living there.

1 EXAMINER SHOWTIS: Was there food on the
2 grill?

3 (Laughter)

4 A. I didn't go that far.

5 Also, one of the president's sons in
6 trying to solve these problems in an informal way
7 did not like what Staff was saying, especially me,
8 and he indicated after that that he would not
9 respond to any of Staff's recommendations unless it
10 was through a formal notice.

11 Q. Mr. King, do you have any reason to
12 believe that the FBI has dug up the service areas
13 of CUCI looking for bodies because of the Mafia?

14 A. I'm not aware of --

15 MS. CONTI: I would object to that question.

16 A. -- any of these facilities -- any of
17 these things going on in Citizens or Illinois -
18 American area.

19 EXAMINER SHOWTIS: Well, there was an
20 objection to that question.

21 MR. CLENNON: Mr. Springer is handling this
22 witness for the Joint Applicants.

1 MS. CONTI: Mr. Springer conducted the cross,
2 and I didn't have any cross, but that doesn't mean
3 that I don't have a right to object to an
4 objectionable question concerning my client.
5 There's no foundation at all concerning any
6 involvement of the FBI in CUCI at all in this
7 record.

8 MS. VON QUALEN: And that was precisely the
9 question that was asked was whether there was any
10 evidence, and I believe this was made relevant by
11 Mr. Springer's questions regarding Utilities
12 Unlimited, and I think Mr. King should be able to
13 clarify his position of why he does not believe
14 there are problems with Citizens Utilities of
15 Illinois as opposed to Utilities Unlimited.

16 EXAMINER SHOWTIS: Well, I think the question
17 that was objected to would result in an answer
18 where Mr. King stated his opinion that he did not
19 believe there was any problems associated with the
20 utility's property that involved activities by the
21 FBI, so I don't think it was a damaging answer. So
22 I'll overrule the objection. I don't know -- I

1 think you were part way into your answer, so why
2 don't you just answer the question again.

3 A. Okay. I'm not aware of any instances
4 where the FBI has been involved with Citizens
5 facilities nor Illinois-American facilities, and I
6 would not expect any of these problems to occur in
7 any of these systems due to the professionalism of
8 the operators and management.

9 MS. VON QUALEN: Thank you. No further
10 questions.

11 EXAMINER SHOWTIS: You can step down.

12 (Witness excused.)

13 MS. VON QUALEN: Could we have a brief break,
14 Your Honor?

15 EXAMINER SHOWTIS: Okay. Do you want to take
16 ten minutes?

17 MR. CLENNON: Please.

18 EXAMINER SHOWTIS: Okay.

19 (Whereupon a recess was
20 taken, during which time
21 Staff Exhibit 4.0 Revised
22 was marked for

1 identification.)

2 EXAMINER SHOWTIS: Back on the record.

3 MS. VON QUALEN: Your Honor, at this time
4 before proceeding with Staff's next witness, the
5 Company and I think all the Intervenor and Staff
6 have agreed to a couple of stipulations, the first
7 one being a stipulation which has been prepared for
8 all the legal descriptions of the certificated
9 areas served by CUCI, and an updated list of
10 certificates of public convenience and necessity as
11 of this date are attached to the stipulation which
12 has been agreed to by the parties.

13 EXAMINER SHOWTIS: Okay. Do you want to have
14 that marked as an exhibit?

15 MS. VON QUALEN: Sure.

16 EXAMINER SHOWTIS: Let's go off the record.

17 (Whereupon at this point in
18 the proceedings an
19 off-the-record discussion
20 transpired, during which
21 time Stipulation Exhibit 1
22 was marked for

1 identification.)

2 EXAMINER SHOWTIS: Go ahead.

3 MS. VON QUALEN: The Company and Staff have
4 also entered into a stipulation as follows: There
5 may be some confusion in the record with regard to
6 whether ICC Staff Exhibit 10.0, Schedule 10.1,
7 reflects revenues from Illinois-American Water
8 Company's pending rate case. ICC Exhibit 10.0,
9 Schedule 10.1, does not reflect revenues from
10 IAWC's current rate case. It was developed from
11 historical 1999 data.

12 MR. SPRINGER: We stipulate that that
13 statement is correct.

14 EXAMINER SHOWTIS: Stipulation Exhibit 1 is
15 admitted into evidence.

16 (Whereupon Stipulation
17 Exhibit 1 was received into
18 evidence.)

19 MR. SPRINGER: Thank you.

20 MR. CLENNON: Staff would call Mr. Hardas to
21 the stand.

22

1 PHIL A. HARDAS
2 called as a witness on behalf of the Staff of the
3 Illinois Commerce Commission, having been first
4 duly sworn, was examined and testified as follows:

5 DIRECT EXAMINATION

6 BY MR. CLENNON:

7 Q. Sir, could you please state your full
8 name for the record?

9 THE WITNESS:

10 A. My name is Phil A. Hardas.

11 Q. Who is your employer and what is your
12 business address?

13 A. My employer is the Illinois Commerce
14 Commission. My business address is 527 East
15 Capitol, Springfield, Illinois 62701.

16 Q. Mr. Hardas, did you prepare written
17 exhibits and schedules to be presented in this
18 proceeding?

19 A. Yes, I did.

20 Q. Do you have before you a document that
21 has been marked for identification purposes as ICC
22 Staff Exhibit 4.0 Revised?

1 A. Yes.

2 Q. Did you prepare this document?

3 A. Yes, I did.

4 Q. Attached to it are a number of schedules
5 that go from Schedule 4.1 to 4.4. Is that correct,
6 sir?

7 A. Yes, it is.

8 Q. Did you prepare those schedules or cause
9 them to be attached to your testimony?

10 A. Yes.

11 Q. Do you also have a document in front of
12 you that's been marked as ICC Staff Exhibit 10?

13 A. Yes, I do.

14 Q. Did you prepare that document for
15 submittal in this proceeding?

16 A. Yes, I also submitted that document.

17 Q. Are there schedules attached to that
18 document, sir?

19 A. Yes, there are.

20 Q. The numbers are?

21 A. 10.1 and Schedule 10.2.

22 Q. Very good.

1 Do you have any additions or corrections
2 to make to those documents?

3 A. Yes, I do.

4 Q. Could you please describe them for the
5 court?

6 A. Yes. On Staff Exhibit 4 of my
7 testimony, direct testimony, on page 2, line 35, it
8 starts out "the proposed reorganization will not",
9 and I added the word "significantly", and then it
10 goes "impair the utility's ability to raise
11 necessary capital", so forth. The change is I
12 added the word "significantly" between "not" and
13 "impair".

14 Q. Are there any other changes?

15 A. Yes, there are. On Exhibit 4, Schedule
16 4.1, the year ended 1999, December 31st numbers for
17 Illinois-American Water Company were revised.

18 Q. What was the purpose of that revision?

19 MR. SPRINGER: I'm sorry. Can I have the page
20 reference again on this?

21 A. I'm sorry. It's Schedule 4.1.

22 MR. SPRINGER: Okay.

1 A. And I'll repeat that again. It was
2 December 31, 1999 data for Illinois -American Water
3 Company, and those ratios were revised.

4 Q. Do you know the old ratios?

5 A. Yes, I do.

6 Q. And what were the old ones and what are
7 the new ones?

8 A. The new ones are as presented in the
9 revised version.

10 Q. And the old ones?

11 A. And the old ones for pre-tax interest
12 coverage was 3.95; net cash flow to expenditures
13 was 46.75 percent; total debt to total capital was
14 52.61 percent; net cash flow to total debt was
15 17.51 percent.

16 Q. Could you recite the new ones for us,
17 sir?

18 A. Yes. Pre-tax interest coverage is 3.34;
19 net cash flow to expenditures is 43.96 percent;
20 total debt to total capital is 52.89 percent; and
21 net cash flow to total debt is 16.89 percent on the
22 revised version.

1 Q. And those are the only numbers to
2 change?

3 A. Yes.

4 Q. What was the purpose of the revision?

5 A. There was detected incorrect data used
6 initially for the Schedule on 10.14, the 1999
7 information for Illinois-American on Schedule 4.1.

8 Q. Do you have any other additions or
9 corrections to make?

10 A. No, I don't.

11 Q. Is the information contained in your
12 testimony and the attached schedules true and
13 correct?

14 A. Yes, they are.

15 Q. If I were to ask you the same questions
16 as set forth in your testimony, would your answers
17 be the same?

18 A. Yes, they are.

19 MR. CLENNON: Mr. Examiner, I move for
20 admission into evidence Staff Exhibit 4.0 and the
21 attached schedules -- 4.0 Revised and the attached
22 schedules, which have been tendered to the Court

1 Reporter, as well as ICC Staff Exhibit 10 and the
2 attached schedules which were prefiled on e-Docket.

3 EXAMINER SHOWTIS: Is there any objection?

4 MR. SPRINGER: No objection.

5 EXAMINER SHOWTIS: Staff Exhibits 4.0 Revised
6 and 10 are admitted into evidence.

7 (Whereupon ICC Staff
8 Exhibits 4.0 Revised and 10
9 were received into
10 evidence.)

11 EXAMINER SHOWTIS: You may cross-examine.

12 MR. SPRINGER: Thank you.

13 CROSS EXAMINATION

14 BY MR. SPRINGER:

15 Q. First, Mr. Hardas, I just wanted to
16 confirm one of the changes you just indicated. At
17 page 2 of your direct testimony, line 35, did you
18 say you added the word "significantly" at that
19 point?

20 A. Yes. On line 35, the entire line should
21 read: "the proposed reorganization will not
22 significantly impair the utility's ability to

1 raise", and then it continues on line 36.

2 Q. Thank you.

3 Mr. Hardas, you have not testified in
4 any prior case with regard to a utility
5 reorganization as defined in Section 7-204 of the
6 Illinois Public Utilities Act. Is that correct?

7 A. Yes, that's correct.

8 Q. In your direct testimony, hopefully the
9 page and line references are the same here, page 5
10 -- give me a moment. The page and line reference
11 has changed for the statement I wanted to ask
12 about. I'll be just a moment.

13 (Pause in the proceedings.)

14 MR. CLENNON: Your Honor, could I have a
15 minute off the record?

16 EXAMINER SHOWTIS: Okay.

17 (Whereupon at this point in
18 the proceedings an
19 off-the-record discussion
20 transpired.)

21 EXAMINER SHOWTIS: Back on the record.

22

1 DIRECT EXAMINATION (Cont'd)

2 BY MR. CLENNON:

3 Q. Mr. Hardas, before we proceed any
4 further, do you have a correction to your
5 corrections?

6 A. Yes, I do. I misspoke earlier. On my
7 change that I first brought to the attention where
8 I said "significantly" on line 35 of page 2 in my
9 direct testimony was added, it was not. The true
10 change on page 5 of Staff Exhibit 4, line 89, the
11 line should read: "The merger with CUCI should not
12 significantly impair Illinois American's financial
13 condition."

14 Q. And just so I'm clear, when you say
15 Illinois American's financial condition, your
16 testimony reads --

17 A. IAWC.

18 Q. Very good.

19 With that change, are all the other
20 foundation questions that I asked you -- would your
21 answers still be the same?

22 A. Yes, they are.

1 EXAMINER SHOWTIS: Mr. Springer.

2 MR. SPRINGER: Thank you.

3 CROSS EXAMINATION (Cont'd)

4 BY MR. SPRINGER:

5 Q. With reference to the sentence that we
6 were just discussing, as I understand it, your
7 original statement in the direct testimony was that
8 the merger with CUCI should not impair IAWC's
9 financial condition. Is that correct?

10 A. Yes, that was what was originally on
11 Exhibit 4.

12 Q. And as revised, the sentence reads: "The
13 merger with CUCI should not significantly impair
14 IAWC's financial condition." Is that correct?

15 A. That's correct.

16 Q. And by merger you're referring to
17 Illinois American's proposed acquisition of CUCI's
18 assets. Is that correct?

19 A. Yes, I am.

20 Q. I take it due to the change that you now
21 have concluded that the acquisition may impair
22 CIWC's financial condition if the merger premium --

1 excuse me. Let me start that question over.

2 I take it that due to the change in your
3 testimony, you've now concluded that if the merger
4 premium or acquisition adjustment is not recovered,
5 the acquisition of CUCI's assets may impair IAWC's
6 financial condition. Is that correct?

7 A. I agree that IAWC's financial condition
8 will decline, and, yes, it will impair.

9 Q. All right. And what was it that caused
10 you to conclude that without recovery of the merger
11 premium or acquisition adjustment, IAWC's financial
12 condition would be impaired?

13 A. I'm sorry. Could you repeat the
14 question?

15 Q. I think so. What was it that led you to
16 conclude that without recovery of the merger
17 premium or acquisition adjustment, IAWC's financial
18 condition would be impaired?

19 A. In Schedule 10.1 of my rebuttal
20 testimony there is three ratios listed: pre-tax
21 interest coverage, cash from operations to interest
22 coverage, and cash from operations to total debt.

1 Those ratios did decline according to historical
2 1999 data that was used and a pro forma calculation
3 that was performed that assumed that the
4 acquisition adjustment would not be accepted.

5 Q. So it was the decline in the ratios that
6 was the cause for your concern, if I understand
7 what you just said?

8 A. I don't know if I would coin it as
9 concern. According to this schedule, they will
10 decline. As I stated in my testimony, I do not
11 believe that they will be significantly impaired,
12 but they will decline.

13 Q. And you indicated earlier that you
14 believe IAWC's financial condition would be
15 impaired absent recovery of the acquisition
16 premium. Correct?

17 A. Yes, and with the use of impaired to
18 mean to decline in strength, yes.

19 Q. Okay. Let's look for a moment at the
20 ratios that you're referring to. The pre-tax
21 interest coverage ratio of Illinois-American, as
22 shown pre-acquisition or without the acquisition,

1 is 3.34, if I understand it. Is that correct?

2 A. That's correct.

3 Q. And post-acquisition absent recovery of
4 the acquisition premium is shown to be 1.86. Is
5 that correct?

6 A. Yes, it is.

7 Q. Now underneath the first coverage level,
8 3.34, you show the S&P benchmark for BBB utilities.
9 Is that correct?

10 A. Yes, I do.

11 Q. And that would be for BBB utilities with
12 a business position of 3? Would that be right?

13 A. That's right.

14 Q. What would the pre-tax interest coverage
15 of 3.34 correspond to in terms of an S&P benchmark
16 that appears to be above the BBB level?

17 A. I'd have to look that up real quick to
18 be precise.

19 (Brief pause in the proceedings.)

20 The range for pre-tax interest coverage
21 for utilities with a business position of 3 for A
22 rated utilities is 3.4 to 2.8, to be precise.

1 Q. All right. And would the range for
2 utilities rated AA be 3.4 to 4.0?

3 A. Subject to check.

4 Q. All right. So you would conclude that
5 the pre-tax interest coverage of Illinois-American
6 in the pre-acquisition column is consistent with an
7 A rating of S&P? Is that correct?

8 A. Yes, I would.

9 Q. What about the cash from operations to
10 interest level? What rating would the 3.81 figure
11 shown in the pre-acquisition column be consistent
12 with?

13 A. I believe that would be A also, but I
14 will have to check.

15 (Brief pause in the proceedings.)

16 Yes, that would be A also.

17 Q. All right. And what about cash from
18 operations to total debt? What benchmark would the
19 16.89 percent figure shown be consistent with?

20 A. That would be in a BBB range.

21 Q. BBB?

22 A. Yes.

1 Q. All right. And now moving over to the
2 column labeled as Pro Forma, which as I understand
3 it would be post-acquisition without recovery of
4 the acquisition premium? Is that right?

5 A. Yes.

6 Q. The pre-tax interest coverage ratio
7 would decline to 1.86, which is toward the low end
8 of the range you show for BBB utilities. Is that
9 right?

10 A. Yes, that's correct.

11 Q. And the cash from operations to interest
12 coverage ratio drops to 2.51 which is, again,
13 within the range for the BBB utilities. Is that
14 correct?

15 A. Yes, that's within the range for BBB
16 utilities.

17 Q. And the cash from operations to total
18 debt ratio drops to 10.15, which is well below the
19 range for BBB utilities. Correct?

20 A. 10.15 percent is in the range for BB,
21 yes.

22 Q. And that's below the range for BBB. Is

1 that correct?

2 A. Yes, it is.

3 Q. BB-rated securities would not be what
4 one would refer to as investment grade securities.
5 Is that correct?

6 A. BB would not.

7 Q. BBB would be the lowest investment grade
8 rating. Is that correct?

9 A. BBB would be a low investment rating.

10 Q. Let's go to your direct testimony, I
11 hope. At page 4, line 64, you indicate that AWCC
12 is responsible for raising debt capital for the
13 subsidiaries of American Water Works. Is that
14 correct?

15 A. Yes.

16 Q. And you refer at page 3 of your
17 testimony, line 40, to a service agreement between
18 American Water Capital Corporation and IAWC. Is
19 that correct?

20 A. Yes.

21 Q. Under that agreement, the financial
22 services provided to Illinois-American by AWCC are

1 those services with respect to which IAWC and AWCC
2 from time to time agree. Is that correct?

3 A. Under my understanding, their agreement
4 exists, but that under certain circumstances it
5 could be broken.

6 Q. All right. Well, would you accept,
7 subject to check, that section 1 on page 1 of the
8 agreement reads as follows? I will indicate that
9 AWCC is referred to in this agreement as AWWFC.

10 A. Okay.

11 Q. "AWWFC will provide either directly or
12 through arrangements with third parties for the
13 benefit of the Company", the Company being
14 Illinois-American Water Company, "such financial
15 services as the Company and AWWFC may from time to
16 time agree." Would you accept that that language
17 is there?

18 A. Subject to check, yes.

19 Q. It is also true, is it not, that AWCC
20 can terminate the agreement on 90 days' written
21 notice?

22 A. Yes, they can.

1 Q. Now to summarize the change in the
2 ratios, going back, again, to Schedule 10.1.

3 A. Okay.

4 Q. The effect of the acquisition absent
5 recovery of the acquisition premium --

6 A. I'm sorry. I'm not there yet.

7 Q. Okay. Let me know when you're ready.

8 A. Okay. I'm there.

9 Q. The effect of the acquisition would be
10 to cause the pre-tax interest coverage ratio,
11 again, absent recovery of the acquisition premium,
12 to fall from an A level to the low end of BBB. Is
13 that correct?

14 A. Yes, that's correct.

15 Q. The cash from operations to interest
16 ratio would fall from an A level down to BBB. Is
17 that correct?

18 A. Yes, that's true.

19 Q. And the cash from operations to debt
20 ratio would fall from a BBB level to a level below
21 BBB. Is that correct?

22 A. Yes, that is correct.

1 Q. And you have indicated that without
2 recovery of the acquisition premium, IAWC's
3 financial position would decline. Is that correct?

4 A. Yes, it would decline.

5 Q. Now referring now to the meaning of the
6 Standard & Poor's ratings, as indicated in the
7 materials you've provided in response to discovery
8 requests, an obligor rated A has strong capacity to
9 meet its financial commitments, but is somewhat
10 more susceptible to the adverse effects of changes
11 in circumstances and economic conditions than
12 obligors in higher rated categories. Is that
13 correct?

14 A. That's correct.

15 MR. CLENNON: Sir? Perhaps Mr. Springer could
16 give a copy of whatever he's reading, maybe
17 identify that for the record, so the record is
18 clear.

19 MR. SPRINGER: I'd be happy to. What I have
20 in front of me is material provided to me by
21 Mr. Hardas, Standard & Poor's Global Utilities
22 Rating Service rating definitions. Do you need a

1 copy of that, Mr. Hardas.

2 A. I have it. Do you have what it's
3 marked, what data request response?

4 Q. It says Attachment H, 1 of 2. It would
5 be to the --

6 A. Attachment H?

7 Q. Yeah. Here, I'll show you.

8 (Whereupon Mr. Springer
9 approached the witness with
10 said document.)

11 MR. CLENNON: Mr. Springer, is this some of
12 the information we had contractual problems with?

13 THE WITNESS: Yes, it is.

14 MR. SPRINGER: I think it is, yes.

15 Q. Do you have that there?

16 A. Yes, I have it. It's Attachment A. Now
17 is that page 2 of 2?

18 Q. Yes, it is.

19 A. Okay. Yes, I have it right in front of
20 me.

21 Q. Would you like me to ask the question
22 again?

1 A. Sure.

2 Q. Okay. The question is, according to the
3 Standard & Poor's rating system material, an
4 obligor rated A has strong capacity to meet its
5 financial commitments, but is somewhat more
6 susceptible to the adverse effects of changes in
7 circumstances and economic conditions than obligors
8 in higher rated categories. Is that correct?

9 A. That's correct.

10 Q. An obligor rated BBB has adequate
11 capacity to meet its financial commitments.
12 However, adverse economic conditions or changing
13 circumstances are more likely to lead to a weakened
14 capacity of the obligor to meet its financial
15 commitments. Is that correct?

16 A. Yes, that's what it states.

17 Q. I believe you indicated that the cash
18 from operations to debt ratio would fall under the
19 scenario where the acquisition goes forward without
20 recovery of the acquisition premium to a BB level.
21 Would that be right?

22 A. Yes, that's correct.

1 Q. And is it correct that an obligor rated
2 BB is less vulnerable in the long term than other
3 lower rated obligors; however, it faces major,
4 ongoing uncertainties and exposure to adverse
5 business, financial, or economic conditions which
6 could lead to the obligor's inadequate capacity to
7 meet its financial commitments?

8 A. As stated in Schedule 10.1, cash from
9 operations to total debt will decline to the BBB
10 rating, although it is not necessary for all ratios
11 to fall within a range to be consistent with its
12 financial credit rating. Rather, all ratios as a
13 whole represent a company's financial condition,
14 and S&P uses both quantitative and qualitative
15 methods to decide a credit rating. These ratios
16 aren't meant to be precise. They're intended to
17 convey ranges that characterize their level of
18 credit quality, and a strengthness in one ratio can
19 compensate or offset relative weakness in another.

20 MR. SPRINGER: Mr. Examiner, I'm going to ask
21 that that statement be stricken. I believe I asked
22 the witness whether a particular ratio would fall

1 to the BB level.

2 A. Well, I'm sorry, but I believe the
3 question to be whether the obligor rated BB on the
4 definition, that's how I read the question to be,
5 as my definition according to what that ratio would
6 do in reference to the ratings definition given by
7 Standard & Poor's for BBB, and that is an obligor
8 rated BBB, and I was merely stating that, yes, my
9 ratio does fall in the BB category for cash from
10 operations to total debt, but that one ratio does
11 not mean that their credit quality would be
12 considered BB or below investment grade.

13 MR. CLENNON: May I respond to the objection?

14 EXAMINER SHOWTIS: No.

15 (Laughter)

16 A. I'm sorry.

17 EXAMINER SHOWTIS: I'm sure if I struck it --
18 it is not responsive. I can strike it, but I would
19 imagine that on redirect I'm going to get something
20 analogous to what Mr. Hardas just said, so,
21 Mr. Springer, I agree it's not responsive. If you
22 want it stricken, that's fine, but I have a funny

1 feeling I'm going to hear the same thing on
2 redirect. So I will strike it at this point.
3 Obviously, Mr. Hardas on redirect would be able to
4 explain what the meaning of a single ratio below
5 investment grade is. So if you want it stricken,
6 that's fine.

7 MR. SPRINGER: All right.

8 Q. Getting back to Schedule 10.1,
9 Mr. Hardas, the cash from operations to total debt
10 ratio in the Pro Forma column post-acquisition
11 without recovery of the acquisition premium
12 declines to a level which is below the range for
13 the S&P BBB benchmark for that ratio. Is that
14 correct?

15 A. Yes, cash from operations to total debt
16 adjusted pro forma combined company after the
17 acquisition without acquisition adjustment is in
18 the BB range. You're correct.

19 Q. And according to the Standard & Poor's
20 rating definitions, an obligor rated BB is less
21 vulnerable in the near term than other lower rated
22 obligors. However, it faces major, ongoing

1 uncertainties and exposure to adverse business,
2 financial, or economic conditions which could lead
3 to the obligor's inadequate capacity to meet its
4 financial commitments. Correct?

5 A. Yes, that is Standard & Poor's
6 definition of BB rating.

7 Q. As a public utility, Illinois -American
8 Water Company is required to provide service to its
9 customers at times of adverse economic conditions
10 or even if circumstances change. Would that be
11 right?

12 A. Yes .

13 Q. Is it true that under the Standard &
14 Poor's ratings, an obligor rated below BBB is
15 regarded as having significant speculative
16 characteristics?

17 A. Yes. According to S&P, a below BBB
18 rating is below investment grade which does have
19 speculative characteristics.

20 Q. And a BB rating indicates the least
21 degree of speculation and CC the highest. Is that
22 correct?

1 A. Yes.

2 Q. All other things being equal, as the S&P
3 rating for a security declines and the obligor's
4 speculative characteristics increase, the cost of
5 debt capital for the obligor also would be expected
6 to increase. Would that be right?

7 A. Yes, it's possible.

8 Q. Now S&P provides, amongst the materials
9 that you provided, a summary of financial ratios
10 for water utilities. Would that be correct?

11 A. Do you have the attachment so I can see
12 in?

13 Q. Yes. And of the companies listed there,
14 California Water Service is the first one. Is that
15 right?

16 A. Yes, it is.

17 Q. And that one has a corporate credit
18 rating of AA-. Is that correct?

19 A. Yes, it does.

20 Q. Is the next one -- the copy you faxed to
21 me is a little hard to read. Is it BHC Company?

22 A. Yes, it is.

1 Q. And is that company rated A+?

2 A. Yes.

3 Q. Southern California Water Company rated

4 A+?

5 A. Yes.

6 Q. Aquarion Company rated A?

7 A. Yes.

8 Q. Middlesex Water Company rated A?

9 A. Yes.

10 Q. United Water -New Jersey rated A?

11 A. Yes.

12 Q. United Water Works rated A?

13 A. Yes, it is.

14 Q. And a subsidiary of American called

15 Pennsylvania-American Water Company rated A-?

16 A. Yes.

17 Q. Now of the companies shown in the

18 summary, there's a column shown there for the

19 pre-tax interest coverage ratio. Is that correct?

20 A. Yes, there is.

21 Q. And the lowest one I found is 2.01 for

22 United Water Works. Is that correct?

1 A. Yes, and I'd like to also be noted that
2 this information is for December 31st of 1997.

3 Q. As I understand it, this was amongst the
4 materials you relied on in this case, is it not?

5 A. Yes, it is.

6 Q. And, again, the lowest coverage shown
7 for the other water utilities we discussed is 2.01?
8 Is that correct?

9 A. Yes, it is correct.

10 Q. And the highest is 4.13 for California
11 Water Service. Is that correct?

12 A. That is also correct.

13 Q. The indicated average interest coverage
14 ratio is 2.77. Is that correct?

15 MR. CLENNON: Mr. Springer, did you say
16 average?

17 MR. SPRINGER: Yes.

18 A. The average for which? For A? AA?

19 Q. Oh, I'm sorry. Yes.

20 A. For A?

21 Q. The average for A is indicated to be
22 2.77?

1 A. Yes, it is.

2 Q. And the average for A+ is 3.32. Is that
3 correct?

4 A. Yes.

5 Q. The average for AA is 4.13. Is that
6 correct?

7 A. That's also correct.

8 Q. And the average for A-, which is only
9 one company, Pennsylvania-American Water Company,
10 is 2.24. Is that correct?

11 A. Yes.

12 Q. And you show on your Schedule 10.1 a pro
13 forma coverage for Illinois-American post-
14 acquisition without recovery of the acquisition
15 premium of 1.86. Is that correct?

16 A. That's correct.

17 Q. And that coverage would be below any
18 shown on the summary. Is that correct?

19 A. Yes, that number would be below any
20 shown on that summary.

21 Q. Your workpapers that you provided
22 supporting your testimony do not include any

1 specific study or analysis of the effect of the
2 decline in financial condition you discuss on
3 Illinois-American's cost of capital. Is that
4 correct?

5 A. That's correct.

6 MR. SPRINGER: Thank you. I have nothing
7 further for Mr. Hardas.

8 EXAMINER SHOWTIS: Do you have any questions,
9 Mr. Fitzhenry?

10 MR. FITZHENRY: No, I do not.

11 EXAMINER SHOWTIS: I just had one question.

12 EXAMINATION

13 BY EXAMINER SHOWTIS:

14 Q. Schedule 10.1, column 1, reflects
15 historical figures as of the end of 1999?

16 A. Yes, December 31, 1999.

17 Q. And it's my understanding that
18 Illinois-American has a pending rate case before
19 this Commission. Is that correct?

20 A. Yes, they do.

21 Q. And I believe a final order is due
22 shortly or within the next month or two. Is that

1 correct?

2 A. Yes.

3 Q. And it's my understanding that rate
4 increases are sought by Illinois-American for
5 certain of its service areas in that proceeding.
6 Is that correct?

7 A. That's my understanding as well.

8 Q. Is the dispute between Illinois-American
9 and other parties in that proceeding over the
10 amount of the increase for various service
11 territories? In other words, is any party
12 recommending no increase for certain service
13 territories or a decrease?

14 A. I'm sorry. I'm not familiar with that
15 exactly.

16 Q. But if there is some rate relief granted
17 to Illinois-American in that case, that would have
18 some impact on the ratios shown in both column 1
19 and in the last column which is entitled Adjusted
20 Pro Forma Combined. Is that correct?

21 A. Yes, that's my understanding that it
22 would.

1 EXAMINER SHOWTIS: Okay. That's all I had.

2 MR. CLENNON: We have some questions. We need
3 a break.

4 EXAMINER SHOWTIS: Okay.

5 (Whereupon a short recess
6 was taken.)

7 EXAMINER SHOWTIS: Back on the record.

8 MR. SPRINGER: Mr. Examiner, before we begin
9 the redirect, I would like to ask leave to ask an
10 additional question of Mr. Hardas that I've
11 discussed with Staff counsel.

12 EXAMINER SHOWTIS: Okay. Go ahead.

13 CROSS EXAMINATION

14 BY MR. SPRINGER:

15 Q. Mr. Hardas, as follow-up to the question
16 the Hearing Examiner asked you, I believe you
17 indicated that Schedule 10.1 does not reflect
18 revenues that may be derived from the ongoing rate
19 case once the order is entered. Is that right?

20 A. Yes.

21 Q. All right. And I guess my question is,
22 is it also correct that the data shown on the

1 schedule does not reflect post 1999 costs
2 associated with changes in operating expenses or
3 plant investment?

4 A. Yes.

5 Q. So that neither revenues nor costs that
6 may be reflected in the rate case data for post
7 1999 periods would be reflected in the schedule.
8 Is that correct?

9 A. That's correct.

10 MR. SPRINGER: Thanks. That's all I have.

11 EXAMINER SHOWTIS: Go ahead.

12 MR. CLENNON: I have some questions, if I may.

13 REDIRECT EXAMINATION

14 BY MR. CLENNON:

15 Q. Mr. Hardas, could you describe for us
16 how S&P uses its benchmark ratios in determining a
17 company's credit rating?

18 A. Yes, I could. The ratios that they use
19 are meant to fall into a range that would show
20 consistency of a particular financial credit
21 rating. They're not meant to be precise. They're
22 intended to convey ranges that characterize levels

1 of credit quality as represented by rating
2 categories, and strengths in one area are able to
3 offset weaknesses in another.

4 Q. Mr. Springer asked you a couple
5 questions concerning the S&P financial benchmark
6 ratios, and I believe three of them were discussed.

7 A. Yes, there were.

8 Q. Is there a fourth one?

9 A. Yes. S&P uses a fourth benchmark ratio
10 which is total debt to total capital.

11 MR. SPRINGER: I'm going to object,
12 Mr. Examiner, to introduction of additional
13 material that was not presented with the witness's
14 direct testimony nor the subject of
15 cross-examination.

16 MR. CLENNON: Your Honor, I believe if you
17 look at Schedule 10.2, the information is contained
18 there. It may not be the exact benchmark
19 described, but certainly the information is there,
20 and it's a clarification of the responses he was
21 giving to Mr. Springer.

22 MR. SPRINGER: Would you give me a moment,

1 Mr. Clennon?

2 MR. CLENNON: 10.2 lists pre-tax interest
3 coverage, net cash flow to expenditures, funds from
4 operations interest coverage, total debt to total
5 capital, net cash flow to total debt.

6 MR. SPRINGER: I withdraw my objection.

7 EXAMINER SHOWTIS: Do you remember the
8 question?

9 THE WITNESS: Yes. Well, I think he objected
10 to my answer.

11 EXAMINER SHOWTIS: Okay.

12 MR. CLENNON: Let me restate the question.

13 THE WITNESS: Okay.

14 Q. Mr. Springer asked you a number of
15 questions about various S&P financial benchmark
16 ratios. Specifically, he covered three.

17 A. Yes.

18 Q. Is my understanding correct that there
19 is a fourth S&P financial benchmark ratio that
20 Mr. Springer did not discuss with you?

21 A. Yes. S&P uses a fourth ratio, and that
22 ratio is total debt to total capital.

1 Q. Mr. Hardas, can you please tell the
2 court what is the total debt to total capital for a
3 BBB benchmark rating for a utility with a business
4 position of 3?

5 A. The range that S&P uses for a BBB
6 utility at business position 3 is 53 percent to 61
7 percent.

8 Q. What is Illinois-American Water
9 Company's pro forma total debt to total capital
10 ratio assuming no merger premium is recovered?

11 A. On Schedule 10.2, total debt to total
12 capitalization is 53.85 percent, and that is in the
13 upper portion of the BBB rating.

14 Q. When you say upper portion, do you mean
15 the high range of BBB rating?

16 A. Yes.

17 Q. Of that benchmark ratio?

18 A. Yes.

19 MR. CLENNON: Very good. Staff has nothing
20 further.

21 MR. SPRINGER: I do have some brief follow-up,
22 Mr. Examiner.

1 RECROSS EXAMINATION

2 BY MR. SPRINGER:

3 Q. With respect to the additional ratio you
4 mentioned, Mr. Hardas, the figure you're giving is
5 the pro forma combined company figure. Is that
6 correct? If I recall the number, it was 53.85
7 percent?

8 A. Yes.

9 Q. What is the number that would correspond
10 to the Illinois-American pre-acquisition ratio in
11 the first column of your Schedule 10.1?

12 A. In Schedule 10.2 or 10.1?

13 Q. I'm just asking for the number that
14 would correspond to those shown as the
15 pre-acquisition ratio numbers.

16 A. Oh. So for Illinois -American Water
17 Company?

18 Q. Yes.

19 A. For 1999?

20 Q. Yes.

21 A. Okay. It will take me just one second.

22 (Brief pause in the proceedings.)

1 I have 52.89 percent.

2 Q. Thank you.

3 You do not show the ratio for total debt
4 to total capital on your Schedule 10.1. Is that
5 correct?

6 A. No, I do not.

7 Q. And I believe you testified that the
8 benchmark ratio levels are not meant to be precise.
9 I believe those were your words. Is that correct?

10 A. That's correct.

11 Q. So that the fact that an entity has say
12 a pre-tax interest coverage ratio that falls within
13 a given benchmark doesn't necessarily mean it would
14 achieve that benchmark. Is that correct?

15 A. The question is if the ratio's number is
16 between the range?

17 Q. Yes. What I'm suggesting is the fact
18 that a given company has a pre-tax interest
19 coverage ratio that's within say the BBB range
20 doesn't necessarily mean that that entity would
21 receive a BBB rating due to the imprecision that
22 you discuss. Is that correct?

1 A. Yes. If certain ratios are in different
2 ranges, it's a combination of all ranges together,
3 yes.

4 Q. So, for example, the fact that the post -
5 acquisition coverage figure is shown to be 1.86,
6 which is just slightly above the bottom of the BBB
7 range, would be something that an analyst would
8 take into account. Is that correct?

9 A. Due to that it's the lower end of BBB?

10 Q. Yes.

11 A. Yes, that could be taken into
12 consideration.

13 Q. And the fact that the cash from
14 operations to total debt ratio is well below the
15 bottom of BBB would be another factor taken into
16 account. Is that correct?

17 A. Yes, that it is a BB rating, yes, that
18 would be taken into account.

19 MR. SPRINGER: Thank you. I have nothing
20 further of Mr. Hardas.

21 EXAMINER SHOWTIS: I just have one question.

22

1 EXAMINATION

2 BY EXAMINER SHOWTIS:

3 Q. If S&P has the four ratios, why did you
4 only include three on Schedule 10.1?

5 A. Well, Mr. Hearing Examiner, Schedule
6 10.1 was initially performed to correct
7 calculations that were performed in Schedule 2.1R,
8 and I tried to keep consistent to how that was
9 performed to show changes, and that number was
10 added or was in Schedule 10.2, but I didn't provide
11 a range, and that's why.

12 EXAMINER SHOWTIS: Okay. That's all I had.

13 MR. CLENNON: Your Honor, if I could just --
14 just two questions.

15 EXAMINER SHOWTIS: A maximum of two.

16 MR. CLENNON: A maximum of two?

17 EXAMINER SHOWTIS: Yes, because I don't want
18 to get into re-redirect and re-recross, so I'll
19 give you two.

20 RE-REDIRECT EXAMINATION

21 BY MR. CLENNON:

22 Q. The schedule in your direct testimony is

1 a correction or a revision or a version of a
2 Company's schedule?

3 A. In my rebuttal testimony, Schedule 10.1?

4 Q. In the earlier schedules.

5 A. No, it is not.

6 Q. I'm sorry; rebuttal schedules. I
7 apologize.

8 A. Yes, 10.1, Schedule 10.1 is a revision.

9 Q. Of?

10 A. Of Exhibit 2.1R that was an Illinois -
11 American Water Company schedule.

12 Q. Very good.

13 Mr. Springer asked you about an analyst
14 lowering a rating because benchmarks or the ratios
15 appeared in the lower range of certain benchmarks.
16 Is it also true that an analyst could give the
17 company a higher range even though its ratios
18 appeared in a lower benchmark?

19 A. Yes, that is true.

20 MR. CLENNON: Very good.

21 I think that was my two.

22 MR. SPRINGER: I have no follow-up.

1 EXAMINER SHOWTIS: Okay. You may step down.

2 (Witness excused.)

3 EXAMINER SHOWTIS: Let's go off the record.

4 (Whereupon at this point in

5 the proceedings an

6 off-the-record discussion

7 transpired, during which

8 time ICC Staff Exhibit 9.0

9 Revised and 3.0 Proprietary

10 were marked for

11 identification.)

12 EXAMINER SHOWTIS: You may proceed.

13 MR. CLENNON: Thank you.

14 Staff would call Ms. Langfeldt.

15 ROCHELLE LANGFELDT

16 called as a witness on behalf of the Staff of the

17 Illinois Commerce Commission, having been first

18 duly sworn, was examined and testified as follows:

19 DIRECT EXAMINATION

20 BY MR. CLENNON:

21 Q. Ms. Langfeldt, please state your name

22 for the record.

1 THE WITNESS:

2 A. Rochelle Langfeldt.

3 Q. Who is your employer and what's your
4 business address?

5 A. The Illinois Commerce Commission, 527
6 East Capitol Avenue, Springfield, Illinois 62701.

7 Q. What is your position here at the
8 Commerce Commission?

9 A. I'm a Financial Analyst.

10 Q. Very good.

11 Ms. Langfeldt, did you prepare written
12 exhibits and schedules for submittal in this
13 proceeding?

14 A. Yes, I did.

15 Q. You have a document -- you have two
16 documents before you which have been marked for
17 identification purposes as Staff Exhibit -- ICC
18 Staff Exhibit 3.0, the Redacted Direct Testimony of
19 Rochelle Langfeldt is the title, and ICC Staff
20 Exhibit 3.0 Proprietary which is marked the
21 Unredacted Direct Testimony of Rochelle Langfeldt.
22 Did you prepare these documents for submission into

1 the record in this proceeding?

2 A. Yes, I did.

3 Q. Are there certain schedules attached to
4 those documents?

5 A. Yes. There's 11 schedules.

6 Q. And they are numbered from 1 to 11?

7 A. Yes, that's correct.

8 Q. And in the unredacted version there are
9 -- Schedule 3 is blank intentionally, redacted
10 intentionally. In the redacted version, Schedule 3
11 is blank. Is that correct?

12 A. That's correct.

13 Q. Four is blank intentionally?

14 A. That's correct.

15 Q. Five is blank?

16 A. Yes.

17 Q. Eight -- I'm sorry -- 7 and 8 as well?

18 A. Yes.

19 Q. And 10. Is that correct?

20 A. Yes, that's correct.

21 MR. CLENNON: And, Your Honor, the redacted
22 version is available on e-Docket.

1 Q. Do you have any additions or corrections
2 to make to ICC Staff Exhibit 3.0, whether it is
3 proprietary or not?

4 A. No.

5 Q. You also have a document before you
6 which is marked ICC Staff Exhibit 9.0 Revised. Is
7 that correct?

8 A. Yes, that's correct.

9 Q. Okay, and you have some additions or
10 corrections to make when this document is compared
11 to the document that was filed on e-Docket. Is
12 that correct?

13 A. That's correct.

14 Q. And could you please describe those
15 changes?

16 A. Yes. On page 3, the sentence that
17 begins at the end of line 48 where it states: "In
18 effect, the market value", it should actually read
19 "In effect, the merger premium".

20 Q. Very good. And the Court Reporter has a
21 copy of the corrected version of that.

22 Is that the only change?

1 were received into
2 evidence.)

3 You may cross-examine, Mr. Springer.

4 CROSS EXAMINATION

5 BY MR. SPRINGER:

6 Q. Ms. Langfeldt, you have not testified in
7 any prior proceeding regarding a public utility
8 reorganization as defined in Section 7-204 of the
9 Illinois Public Utilities Act. Correct?

10 A. That's correct.

11 Q. Referring first to your direct testimony
12 at page 3, line 51, you indicate there that you
13 concluded that IAWC's measurement of the merger
14 premium is incorrect. Is that your statement?

15 A. Yes.

16 Q. Company witness Hamilton defines
17 acquisition premium as the difference between the
18 price paid and the book value of assets. Is that
19 correct?

20 A. Yes.

21 Q. You define that difference as an
22 acquisition adjustment, as you indicate at lines 19

1 to 22 on page 2 of your rebuttal testimony. Is
2 that correct?

3 A. Yes.

4 Q. In concluding that the Company's
5 measurement of the merger premium is incorrect, you
6 did not rely on provisions of the Commission's
7 Uniform System of Accounts with regard to
8 acquisition adjustments. Correct?

9 MR. CLENNON: Can I have the question read
10 back?

11 EXAMINER SHOWTIS: Go ahead.

12 (Whereupon the requested
13 portion of the record was
14 read back by the Court
15 Reporter.)

16 MR. CLENNON: I'm going to object to that
17 question. It hasn't been established that the
18 merger premium is defined in the Uniform System of
19 Accounts.

20 MR. SPRINGER: I have no response to that.
21 The question is whether the witness relied on any
22 provisions of the Uniform System of Accounts in

1 reaching the conclusion. I think it's a perfectly
2 appropriate question.

3 EXAMINER SHOWTIS: She can answer the
4 question. I think the Company has used the term
5 acquisition adjustment, and so with regard to
6 whether you call it a merger premium or acquisition
7 adjustment, you should indicate whether you took
8 into account anything in the Uniform System of
9 Accounts in determining how you calculated the
10 merger premium.

11 A. As I state on line 19 of my rebuttal
12 testimony, I relied on Staff witness Thomas Q.
13 Smith's testimony in defining acquisition
14 adjustment.

15 MR. SPRINGER: I'm going to ask for that
16 statement to be stricken and ask for a response to
17 the question regarding whether the witness relied
18 on any provisions of the Uniform System of
19 Accounts.

20 EXAMINER SHOWTIS: I think you can answer that
21 yes or no.

22 A. No.

1 Q. So you did not rely on provisions of the
2 Uniform System of Accounts in reaching your
3 conclusion. Correct?

4 MR. CLENNON: Asked and answered, Your Honor.

5 MR. SPRINGER: I'm just trying to make clear
6 what the answer was. I believe that was the
7 answer. I just want to confirm it.

8 A. No, I did not rely on the Uniform System
9 of Accounts.

10 Q. Thank you.

11 And you agree that there are no
12 provisions of the Uniform System of Accounts for
13 either water or sewer utilities which refer to a
14 merger premium as you use that term at page 2, line
15 35. Correct?

16 MR. CLENNON: Beyond the scope, Your Honor.

17 EXAMINER SHOWTIS: She can answer if she
18 knows. If she doesn't know, that can be her
19 answer.

20 A. No, I don't believe the Uniform System
21 of Accounts defines merger premium.

22 Q. The phrase merger premium as you use it

1 is not defined in either Black's Law Dictionary or
2 Barron's Dictionary of Finance and Investment
3 Terms. Is that correct?

4 A. That's correct.

5 Q. You rely on the order in Docket 95 -0551
6 as support for your definition of a merger premium.
7 Is that correct?

8 A. Yes, that is correct.

9 Q. And specifically, you rely on the
10 description given by a witness for the applicants
11 in that docket. Is that correct?

12 A. Well, I relied on the order, so I'm not
13 clear who exactly defined merger premium, but that
14 was the definition that they used in the order.

15 MR. SPRINGER: I'm distributing a document I'd
16 like to have marked as Illinois -American Water
17 Company Cross-Examination Exhibit Number 1.

18 (Whereupon IAWC Cross
19 Exhibit 1 was marked for
20 identification.)

21 Q. Do you have in front of you the document
22 that's been marked as Cross-Examination Exhibit

1 Number 1?

2 A. Yes.

3 Q. And this is a data request that asks --
4 it states: "At page 3, beginning at line 51,
5 Ms. Langfeldt states, 'I've concluded that IAWC's
6 measurement of the merger premium is incorrect.'
7 identify by name, docket number and date any
8 regulatory commission order or other document upon
9 which Ms. Langfeldt relies in support of the
10 statement. Also, identify any provisions of the
11 Uniform System of Accounts or other rule upon which
12 Ms. Langfeldt relies." Is that correct? Is that
13 the question?

14 A. That's correct.

15 Q. And is your response to the question
16 given accurate?

17 A. Yes.

18 Q. And this accurately portrays your
19 response?

20 A. Yes.

21 Q. Now you indicate in the first paragraph
22 of your response, in Docket No. 95-0551, merger

1 premiums are defined as "the value over the stock
2 market valuation prior to announcement of the
3 merger". Is that correct?

4 A. Yes, that's correct.

5 Q. And you cite there Order, Docket No.
6 95-0551, September 10, 1997 at page 17. Is that
7 correct?

8 A. Yes.

9 Q. At that page of the order there is a
10 statement Applicant's witness Kimmelman testified
11 that the merger premium represents the value over
12 the stock market valuation prior to announcement of
13 the merger to be received by CIPSCO stockholders.
14 Is that the statement you relied on?

15 A. I believe so. Yes.

16 Q. Then you rely specifically on a
17 description given by a witness for the Applicants
18 in Docket 95-0551 for your definition of the merger
19 premium. Is that correct?

20 A. Yes. That's the definition that the
21 Commission accepted in their order.

22 Q. And the Commission accepted that

1 definition at page 17?

2 A. No, not if page 17 is the page you just
3 read.

4 MR. SPRINGER: All right. I'm going to ask
5 for admission, Mr. Examiner, of Illinois -American
6 Cross-Examination Exhibit 1.

7 MR. CLENNON: We have no objection.

8 EXAMINER SHOWTIS: That exhibit is admitted
9 into evidence.

10 (Whereupon IAWC Cross
11 Exhibit 1 was received into
12 evidence.)

13 MR. SPRINGER:

14 Q. Now let's get to the Commission's
15 conclusion. Would you agree that that's stated at
16 page 30 of the order?

17 A. I don't have that order with me. I'm
18 sorry.

19 Q. Would you accept that at page 30 the
20 Commission states as follows: 95-0551 --

21 MR. CLENNON: Your Honor, I think it's time to
22 object to this line of questioning. Yesterday when

1 I was asking about cases and orders, I was
2 instructed not to. The orders speak for
3 themselves, and we prefer the same courtesy be
4 given Mr. Springer as was given to me last night.

5 MR. SPRINGER: May I respond, Mr. Examiner?

6 EXAMINER SHOWTIS: Yes.

7 MR. SPRINGER: The witness has testified that
8 she relied on an order as the sole source of the
9 definition of a merger premium, which is the
10 subject of her testimony. In this circumstance the
11 order is very relevant to the witness's testimony,
12 and she has just stated that the Commission
13 conclusion was to adopt a certain definition, and
14 it's the Commission's conclusion that I am now
15 going to address.

16 MR. CLENNON: That mischaracterizes
17 Ms. Langfeldt's testimony. If Mr. Springer would
18 have let her answer an earlier answer, she would
19 have discussed also other sources where she relied
20 upon to get that information, but Ms. Langfeldt was
21 cut off. Now, once again, the orders speak for
22 themselves, and Mr. Springer is free to make any

1 legal arguments in his brief.

2 MR. SPRINGER: Again, Mr. Examiner, the
3 witness has testified to reliance on a Commission
4 conclusion in Docket 95-0551, and I believe that
5 questions regarding that conclusion are
6 appropriate.

7 EXAMINER SHOWTIS: Well, I'm having a hard
8 time distinguishing from what happened yesterday
9 when a witness was citing some cases in his
10 testimony, and I left that to the briefs.

11 I think the order does speak for itself,
12 and I think counsel is free to cite the order in
13 the briefs as to whether there was any conclusion
14 in that order on the appropriate measurement of a
15 merger premium.

16 MR. SPRINGER:

17 Q. Is your testimony, Ms. Langfeldt, based
18 on an assumption that the order in Docket 95-0551
19 contains some Commission conclusion?

20 MR. CLENNON: Your Honor, I've already
21 objected to this, and you have ruled on it. Now
22 Mr. Springer is taking a second bite at the apple.

1 MR. SPRINGER: I'm not asking about a
2 statement in the order. I'm asking about the basis
3 for the witness's testimony at this point.

4 MR. CLENNON: Mr. Springer is attempting to
5 get into the back door what he could not get into
6 the front.

7 MR. SPRINGER: I have no further response.

8 EXAMINER SHOWTIS: You can answer the
9 question, whether you believe that the Commission
10 reached a conclusion in that order with regard to
11 the proper measurement of the merger premium.

12 A. Yes.

13 Q. And that's the basis of your testimony
14 in this case?

15 A. That and my knowledge of finance.

16 Q. Now the DCF analysis is the most
17 appropriate method for measuring merger premiums.

18 Is that correct?

19 A. Yes.

20 Q. The DCF analysis requires an estimation
21 of future cash flows for a company which are then
22 discounted to their present value. Is that

1 correct?

2 A. That's correct.

3 Q. The DCF method then develops a valuation
4 for the acquired assets based upon the expected
5 future cash flows. Is that correct?

6 A. Will you repeat that, please?

7 Q. The DCF method then develops a valuation
8 for the acquired assets based upon the expected
9 future cash flows. Is that correct?

10 A. Yes.

11 Q. The results of the DCF analysis,
12 excluding expected savings, represent estimates of
13 the value of the acquired operation prior to
14 acquisition. Is that correct?

15 A. Will you read that again, please?

16 Q. The results of the DCF analysis,
17 excluding expected savings, represent estimates of
18 the value of the acquired operation prior to
19 acquisition. Is that correct?

20 A. That's correct.

21 Q. The DCF results reflect the cash flows
22 that the acquired operation would be expected to

1 realize if no changes were made to operations. Is
2 that correct?

3 A. That's correct.

4 Q. The DCF analysis, which includes
5 savings, implicitly assumes that the parent would
6 retain the economic equivalent of 100 percent of
7 the savings resulting from the acquisition. Is
8 that correct?

9 A. That's correct.

10 Q. At page 4 of your rebuttal testimony,
11 lines 58 to 60, you indicate that ratemaking is a
12 process of balancing ratepayer and investor
13 interests. Is that correct?

14 A. Yes.

15 Q. In balancing ratepayer interests, you
16 consider the customer benefits discussed by
17 Mr. Kelleher to be irrelevant. Is that correct?

18 A. The benefits discussed by Mr. Kelleher
19 were irrelevant as far as my financial analysis.

20 Q. In your rebuttal testimony at pages 7
21 and 8 you make reference to what you say is a
22 proposal of Consumers Illinois Water Company in

1 Docket 97-0351. Is that correct?

2 A. Yes.

3 Q. And as indicated in your Data Response
4 No. 16 to the Company's Third Data Requests, your
5 intent there is to refer to an argument presented
6 in that case by a Dr. Phillips. Is that correct?

7 A. That's correct.

8 MR. SPRINGER: I have a document I'd like
9 marked as Illinois-American Water Company
10 Cross-Examination Exhibit Number 2.

11 (Whereupon IAWC Cross
12 Exhibit 2 was marked for
13 identification.)

14 MR. CLENNON: Before Mr. Springer gets
15 started, before he sits down, I have an objection
16 to the use of this document in this proceeding.
17 This appears to be a small portion of what could be
18 a very large piece of testimony and is only one
19 portion of this witness's testimony. I would
20 venture to say that this witness filed direct,
21 which this may be part of, rebuttal, surrebuttal.
22 In addition to this, this witness's testimony in

1 this previous docket should not be introduced into
2 this docket. The witness is unavailable to sit for
3 cross, and this should not be admitted, nor should
4 Ms. Langfeldt be questioned on it.

5 MR. SPRINGER: Mr. Examiner, at this point I
6 have not moved admission of the exhibit, and I will
7 lay the ground work for use of the exhibit in my
8 cross-examination questions.

9 EXAMINER SHOWTIS: You can proceed for now.

10 MR. SPRINGER: Thank you.

11 Q. Ms. Langfeldt, does the document marked
12 as IAWC Cross-Examination Exhibit Number 2 set
13 forth the entire language of Dr. Phillips that you
14 quote in your Data Response No. 16 as being the
15 argument to which you refer in your testimony?

16 A. Yes.

17 MR. SPRINGER: Thank you.

18 Now I would like to move admission of
19 IAWC Cross-Examination Exhibit Number 2.

20 MR. CLENNON: And I will renew my objection.
21 Your Honor, --

22 EXAMINER SHOWTIS: This is the argument that

1 she relied on. If she placed reliance on page 4
2 through line 14 --

3 MR. CLENNON: That has not been established in
4 this record.

5 EXAMINER SHOWTIS: She just said that is the
6 argument that she relied on as being rejected.

7 MR. SPRINGER: That was what she did say.

8 MR. CLENNON: Your Honor, they had an
9 opportunity to rebut this in their surrebuttal
10 testimony. They forgo that when they do not
11 respond. This is completely inappropriate.

12 EXAMINER SHOWTIS: I don't think it is. I
13 think if she relied on this paragraph, he's just
14 showing what she relied on. It just clarifies the
15 position that the witness indicated was rejected.

16 MR. CLENNON: Very good.

17 MR. SPRINGER: Thank you.

18 Has there been a ruling on the exhibit?

19 EXAMINER SHOWTIS: Yes.

20 MR. SPRINGER: Thank you.

21 EXAMINER SHOWTIS: IAWC Cross Exhibit 2 is
22 admitted, and it's only admitted for purposes of

1 establishing that this is the position or argument
2 that was rejected in that docket that Ms. Langfeldt
3 cited in her testimony.

4 (Whereupon IAWC Cross
5 Exhibit 2 was received into
6 evidence.)

7 MR. SPRINGER: Thank you.

8 Q. Now the argument set forth on the
9 exhibit, Ms. Langfeldt, -- or excuse me -- the
10 testimony set forth does not refer to the terms
11 acquisition premium or premium. Is that correct?

12 A. Well, my testimony did not state that
13 the company asked for an acquisition premium to
14 rate base. They asked for an acquisition premium
15 to the rate of return.

16 Q. So this is a portion of the company's
17 rate of return testimony. Is that correct?

18 A. Correct.

19 Q. Turning now to page 9 of your rebuttal
20 testimony, beginning at line 170, you state there
21 that there is no logical basis for the Company to
22 assume that the ratepayers would be charged for a

1 premium that has no effect on merger savings and
2 which resulted from negotiations in which
3 ratepayers did not participate. Is that correct?

4 A. Yes.

5 Q. You have not analyzed whether or not
6 certain savings would occur as a result of the
7 acquisition. Is that correct?

8 A. That's correct.

9 Q. And as already discussed, for purposes
10 of your analysis you consider the nonmonetary
11 benefits discussed by Mr. Kelleher to be
12 irrelevant. Is that correct?

13 A. Relevant to my financial analysis, yes.

14 Q. At page 10 of your rebuttal testimony,
15 beginning at line 191, you state, "Allowing IAWC to
16 recover a portion of the merger premium through
17 ratepayers would effectively reduce risks to
18 shareholders associated with acquisitions." Is
19 that correct?

20 A. Yes.

21 Q. The only risk to ratepayers you identify
22 is the possibility that the acquisition may not

1 generate sufficient savings. Is that correct?

2 A. Will you read the question back, please,
3 or can I have the question read back to me, please?

4 Q. Yes. The question is, the only risk to
5 ratepayers you identify, however, is the
6 possibility that the acquisition may not generate
7 sufficient savings. Is that correct?

8 A. No. I also mention a risk that in
9 future acquisitions merger premiums will increase.

10 Q. All right.

11 A. If IAWC is allowed to recover a portion
12 of the merger premium.

13 Q. All right. Do you have a copy of your
14 response number 20 to Illinois American's Third
15 Data Request?

16 A. Yes.

17 Q. Was the question there, "With reference
18 to Ms. Langfeldt's statement at page 10, lines 191
19 to 193, state whether Ms. Langfeldt agrees that the
20 shareholders, in fact, assume the risks associated
21 with the proposed Saving Sharing Proposal that
22 savings either are not realized or cannot be

1 demonstrated. If Ms. Langfeldt does not agree,
2 provide the basis for the disagreement and all
3 documents Ms. Langfeldt relies upon to support her
4 position." Is that the question?

5 A. Yes.

6 Q. And is the response: "No. Ms. Langfeldt
7 does not agree that the shareholders assume all the
8 risks associated with the proposed Savings Sharing
9 Proposal. Ratepayers bear risks associated with
10 the
11 SSP because if the merger does not generate the
12 sufficient savings, IAWC's financial condition
13 could deteriorate, thereby increasing the cost of
14 capital. Please see Staff response to Company Data
15 Request 1 which lists the documents relied upon by
16 Ms. Langfeldt in developing her testimony." Was
17 that the response?

18 A. Yes.

19 MR. CLENNON: Your Honor, I would move to
20 strike both the last question and answer.
21 Ms. Langfeldt's testimony is not inconsistent with
22 her data request response, despite the inference

1 Mr. Springer is failing to show. The questions
2 were different, and Ms. Langfeldt answered them
3 correctly both times.

4 MR. SPRINGER: Mr. Examiner, the witness
5 identified one risk borne by ratepayers in this
6 response. The question and answer are relevant to
7 her testimony, and I think the --

8 MR. CLENNON: Your Honor, the question first
9 posed by Mr. Springer was whether or not the
10 ratepayers -- whether or not she -- whether or not
11 there were other risks, and we can have the
12 question read back to us, but the question was more
13 encompassing than the data request. Despite
14 Mr. Springer's attempt, there is no inconsistency
15 between the two.

16 MR. SPRINGER: The data request asked
17 Ms. Langfeldt to provide the basis for her
18 disagreement with the statement that shareholders
19 assumed the risk associated with the proposed
20 Savings Sharing Proposal. That was the question.
21 In the answer she provided the basis for the
22 disagreement, and it was a different basis than was

1 stated here. In any event, the question and answer
2 are relevant to her testimony, and the question is
3 proper.

4 EXAMINER SHOWTIS: The objection is overruled.
5 Obviously, if IAWC wants to place reliance on that
6 particular data request response in its brief and
7 Staff believes there's some misrepresentations,
8 Staff can respond in its reply brief.

9 MR. CLENNON: Very good.

10 MR. SPRINGER: I don't know if we got an
11 answer in the record.

12 Q. Was the response read accurately?

13 A. The response to which question?

14 Q. The response to Data Request No. 20.

15 A. Yes, that was read accurately.

16 Q. Thank you.

17 MR. SPRINGER: That's all the questions I have
18 for Ms. Langfeldt.

19 EXAMINER SHOWTIS: Do you have any questions?

20 MR. FITZHENRY: No.

21 EXAMINER SHOWTIS: I just had a couple
22 questions.

1 EXAMINATION

2 BY EXAMINER SHOWTIS:

3 Q. It is my understanding that you
4 disagreed with the manner in which IAWC calculated
5 the merger premium or acquisition adjustment. I
6 think different terms have been used, and you
7 expressed your position as to how it should be
8 calculated, but you did not make that calculation
9 yourself. Is that correct?

10 A. That's correct.

11 Q. And would you just explain why you did
12 not make a calculation of the merger premium?

13 A. I couldn't calculate the merger premium
14 for the utility assets because I had no way of
15 determining what their expected future cash flows
16 would be because American Water Works acquired all
17 of the utility assets of Citizens and did a single
18 DCF analysis and allocated the purchase price
19 between states and then further within Illinois by
20 -- well, I'm sorry. The parent, American Water
21 Works, allocated the purchase price to the six
22 states on gross property plant and equipment, and

1 then Illinois-American allocated the purchase price
2 for the Illinois -- the three acquisitions in
3 Illinois, the three companies they're acquiring, in
4 a manner that made it impossible for me to estimate
5 what their future cash flows would be.

6 Q. Just for clarification, IAWC witness
7 Gorman presented a calculation of I think he
8 characterized it as a control premium.

9 A. Yes.

10 Q. Would the manner in which you recommend
11 the premium be calculated result in a control
12 premium? In other words, I'm trying to get an
13 understanding if at least the concept is the same
14 between --

15 A. Yes, it is.

16 Q. -- how you say the premium should be
17 calculated and how Mr. Gorman calculated it.

18 A. Yes. We both defined the merger premium
19 as a control premium, the difference between the
20 purchase price and the market value of the utility
21 assets.

22 EXAMINER SHOWTIS: Just a minute.

1 (Pause in the proceedings.)

2 Q. Is it your position that any recognition
3 of a merger premium in rates would provide
4 incentive for higher merger premiums in the future?

5 A. Yes.

6 Q. And would that incentive increase as the
7 amount of the merger premium included in rates
8 would increase? In other words, there could be a
9 situation where the end result is that 5 percent of
10 the merger premium is included in rates versus
11 another case where 85 or 90 percent of the merger
12 premium is included in rates. I would assume that
13 the higher the amount included in rates with regard
14 to the merger premium under your position, the
15 greater the incentive that you referenced.

16 A. That is my position. The greater the
17 proportion of the merger premium the company is
18 allowed to recover or retain would provide
19 incentive for higher merger premiums in future
20 acquisitions.

21 EXAMINER SHOWTIS: Okay. That's all I had.

22 MR. CLENNON: Can we just have one minute?

1 EXAMINER SHOWTIS: Okay.

2 (Pause in the proceedings.)

3 MR. CLENNON: Staff has no redirect for this
4 witness.

5 EXAMINER SHOWTIS: You may step down.

6 (Witness excused.)

7 (Whereupon ICC Staff
8 Exhibit 1.0 Revised was
9 marked for identification.)

10 EXAMINER SHOWTIS: You may proceed.

11 MS. VON QUALEN: Thank you.

12 THOMAS Q. SMITH
13 called as a witness on behalf of the Staff of the
14 Illinois Commerce Commission, having been first
15 duly sworn, was examined and testified as follows:

16 DIRECT EXAMINATION

17 BY MS. VON QUALEN:

18 Q. Please state your full name for the
19 record.

20 THE WITNESS:

21 A. Thomas Q. Smith.

22 Q. Who is your employer and what is your

1 business address?

2 A. The Illinois Commerce Commission, 527
3 East Capitol Avenue, Springfield, Illinois.

4 Q. What is your position at the Commission?

5 A. I'm an accountant.

6 Q. Did you prepare written exhibits and
7 schedules for submittal in this proceeding?

8 A. Yes, I did.

9 Q. You have before you a document which is
10 entitled ICC Staff Exhibit 1, Direct Testimony of
11 Thomas Q. Smith. Did you prepare that for this
12 proceeding?

13 A. Yes, I did.

14 Q. Let me correct that. It's entitled ICC
15 Staff Exhibit 1.0 Revised.

16 A. Yes.

17 Q. Direct Testimony Revised of Thomas Q.
18 Smith.

19 A. That's correct.

20 Q. And does that document reflect any
21 additions or corrections to the Staff exhibit that
22 was originally filed?

1 A. Yes, it does.

2 Q. And what changes does it reflect?

3 A. On page 7 at line 138 the word "because"
4 has been eliminated and the sentence will read: "If
5 savings result from improved management".

6 On page 9 at line 189 the sentence will
7 read: "investors to pay a price above the original
8 cost". The word "paid" has been eliminated.

9 MS. CONTI: What was that line again.

10 A. That was line 189 on page 9.

11 And on page 14, line 303, the sentence
12 has been revised to read: "While there might be
13 savings and those savings might reduce", the words
14 "will result" have been eliminated.

15 Q. Is that all the corrections?

16 A. Yes, it is.

17 Q. And you also have before you ICC Staff
18 Exhibit 7.0 entitled Rebuttal Testimony of Thomas
19 Q. Smith?

20 A. Yes, I do.

21 Q. And did you also prepare that document
22 for presentation in this proceeding?

1 were received into
2 evidence.)

3 MS. VON QUALEN: Mr. Smith is available for
4 cross-examination.

5 CROSS EXAMINATION

6 BY MR. SPRINGER:

7 Q. Good afternoon, Mr. Smith.

8 Please refer first to page 2 of your
9 direct testimony. There you refer to the
10 transaction in this proceeding as a merger. Is
11 that correct, line 42?

12 A. Yes, I do.

13 Q. You use the term merger in your
14 testimony in a general sense, and you refer to the
15 combination of the assets with Citizens of
16 Illinois-American Water Company. Is that correct?

17 A. Yes, I do.

18 Q. At page 4 of your direct testimony,
19 beginning at line 74, you indicate the Commission
20 previously addressed merger transaction costs in
21 Dockets 98-0555 and 98-0866. Is that correct?

22 A. Yes, that's correct.

1 Q. And you refer to the acquisition related
2 costs in this proceeding as merger transaction
3 costs. Would that be right?

4 A. Acquisition related costs, I'm --

5 Q. I'm referring --

6 A. Can you be more specific about which
7 costs?

8 Q. The costs associated with the recovery
9 of the acquisition premium.

10 A. Yes, that's correct.

11 Q. In support of your position that the
12 acquisition premium related costs should be
13 characterized as transaction costs, you rely, in
14 part, on the Commission's Order in Docket 98-0866
15 which on page 42 identifies various one-time costs
16 relating to a merger, including brokerage fees,
17 legal fees, and accounting fees. Is that correct?

18 A. In that general context, yes.

19 Q. And at page 4, line 82, you indicate
20 there that a merger premium is a transaction cost
21 comparable to the other merger fees and expenses
22 you list at lines 78 to 79. Correct?

1 A. I certainly indicated that it's a
2 transaction cost. I don't use the term comparable
3 I don't believe.

4 Q. What you say is transaction costs
5 include one-time costs relating to the merger, such
6 as banker or brokerage fees, legal fees, and
7 accounting fees. Is that your statement?

8 A. Yes, it is.

9 Q. And then you state right below that that
10 the merger premium is also a transaction cost.
11 Correct?

12 A. Yes.

13 Q. At page 6 of your direct testimony,
14 beginning at line 120, you discuss a plant
15 acquisition adjustment. Is that correct?

16 A. That's correct.

17 Q. In her testimony, Staff witness
18 Langfeldt at page 2 of the rebuttal, lines 28 to
19 30, states, "I consider the terms acquisition and
20 merger to be equivalent terms, and I consider the
21 terms acquisition premium and merger premium to be
22 equivalent terms throughout my testimony." Does

1 this statement also apply to your testimony?

2 A. I use the term acquisition adjustment to
3 mean that that's the difference between the price
4 paid or the price to be paid and the original cost
5 as adjusted for accumulated depreciation. I may
6 well have used the term merger premium to encompass
7 that whole amount or some portion thereof. I don't
8 think I would have necessarily used the term merger
9 premium in the way other individuals have used
10 merger premium for purposes of their testimony. My
11 concern is the difference between original cost and
12 purchase price, so if I've used merger premium, it
13 would in some way relate to identifying all or a
14 portion of that difference.

15 Q. And that's all or a portion of the
16 acquisition adjustment, if I understand what you
17 just said?

18 A. Yes.

19 Q. In your direct testimony at page 7,
20 beginning at line 141, you indicate that it would
21 not make sense for Illinois-American to recover a
22 plant acquisition adjustment in revenue

1 requirement. Correct?

2 A. Just so we're together in terms of
3 lines, you directed me to 141. I'm referring to --
4 that's part of -- in my copy anyway part of an
5 answer that addresses the question of whether or
6 not it makes sense for Illinois-American to include
7 recovery of a plant acquisition adjustment, and my
8 response to that question is no.

9 Q. Okay. And you suggest at lines --
10 excuse me. Go to your rebuttal testimony, if you
11 would, please, page 2. You suggest there at lines
12 41 and 42 -- by the way, before I read the quote,
13 is the word discerning on line 41 the word you
14 intended or was it discernible? I wasn't sure.

15 A. Discernible probably would be the
16 appropriate word, yes.

17 Q. All right. So with that change, at that
18 point of your testimony you suggest that Illinois
19 American's proposal is not based on any discernible
20 accounting, costing, or ratemaking principles with
21 which you are familiar. Is that correct?

22 A. Yes, it is.

1 Q. Now going back to your direct testimony
2 for a moment, there you discuss Account 114 of the
3 Uniform System of Accounts for water utilities. Is
4 that correct?

5 A. Yes. I know I have. I don't see it on
6 the page I'm looking at, but.

7 Q. All right. It's the answer to the
8 question which on my copy is on page 6, line 119,
9 what is a plant acquisition adjustment. This is in
10 your direct testimony, if you're looking there.

11 A. Okay.

12 Q. And in that answer you discuss Account
13 114. Is that correct?

14 A. That's correct.

15 Q. Under the Uniform System of Accounts,
16 Account 114 is the account in which a plant
17 acquisition adjustment would be recorded. Is that
18 correct?

19 A. Yes.

20 Q. And paragraph (c) of that account
21 states, "The amounts recorded in this account with
22 respect to each property acquisition shall be

1 amortized or otherwise disposed of as the
2 Commission may approve or direct." Is that
3 correct?

4 MS. VON QUALEN: Do you have a copy of that to
5 show Mr. Smith?

6 MR. SPRINGER: I do.

7 Q. Do you need one, Mr. Smith?

8 A. If I see it, then I can know for sure.

9 (Whereupon said document
10 was provided to the witness
11 by Mr. Springer.)

12 A. Yeah. Paragraph (c) says the amounts
13 recorded in this account with respect to each
14 property acquisition shall be amortized or
15 otherwise disposed of as the Commission may approve
16 or direct.

17 Q. Thank you.

18 Now as we discussed, you believe that
19 the merger premium or acquisition adjustment is a
20 transaction cost similar to the other merger fees
21 and expenses you list in your testimony. Correct?

22 A. Yes.

1 Q. Under the Uniform System of Accounts for
2 water utilities, fees and expenses for mergers or
3 consolidations are recorded in Account 301,
4 Organization. Correct?

5 A. If I could see a copy of Account 301, I
6 would appreciate it.

7 (Whereupon said document
8 was provided to the witness
9 by Mr. Springer.)

10 Yes. Account 301 includes provisions
11 for recording fees and other organizational costs
12 within that account.

13 Q. And one of the listed items for Account
14 301 is fees and expenses for mergers or
15 consolidations. Correct?

16 A. Yes, that's correct.

17 Q. Now Account 301 is a utility plant
18 account. Is that correct?

19 A. Yes.

20 Q. The control account for Account 301 is
21 Account 101, Utility Plant in Service, correct?

22 A. Correct.

1 Q. Account 101, Plant in Service, is a rate
2 base account. Correct?

3 A. Rate base is constructed to include
4 usually the bulk of what's included in Account 101,
5 and I go on to say rather than the bulk,
6 substantially everything in Account 101, yes.

7 Q. Now in an appropriate case, you believe
8 that under Account 114 the Commission has the
9 authority to direct that an acquisition adjustment
10 be included in the cost of service in establishing
11 rates. Is that correct?

12 A. Appropriate case. I think you used the
13 term appropriate case or not. Could I have the
14 question --

15 Q. I can ask it again, if you'd like. You
16 believe that in an appropriate case, that under
17 Account 114 the Commission has the authority to
18 direct that an acquisition adjustment be included
19 in the cost of service in establishing rates. Is
20 that correct?

21 MS. VON QUALEN: Do you have a reference for
22 the witness?

1 MR. SPRINGER: I'm just asking him a question.

2 A. And I've got difficulty at the very
3 least with the term appropriate case. I'm not sure
4 what you're asking by that.

5 Q. All right. Well, let me try it without
6 that phrase, if that's the troublesome one.

7 You believe that under Account 114 the
8 Commission has the authority to direct that an
9 acquisition adjustment be included in the cost of
10 service in establishing rates. Is that correct?

11 A. Account 114 provides options I suppose
12 for the Commission. The accounts are designed to
13 record costs in accordance with what the Commission
14 decides. So if the Commission has authority to
15 provide for amortization and cost of service, then
16 Account 114 would provide a mechanism for doing
17 that.

18 Q. All right. Mr. Smith, do you have your
19 response to the Company's Data Request No. 19 of
20 the First Data Request?

21 A. 19?

22 Q. Yes.

1 A. Yes, I do.

2 Q. The first thing you say there is while
3 offering no legal opinion, Mr. Smith believes that
4 the Commission has the authority to direct that an
5 acquisition adjustment be included in the cost of
6 service for establishing rates. Is that what it
7 says?

8 A. Yes.

9 Q. And you agree with that?

10 A. Yes, I do.

11 Q. Now assuming that the Commission directs
12 that recovery of an acquisition adjustment is
13 appropriate, you believe it should be recorded in
14 Account 406, Amortization of Utility Plant
15 Acquisition Adjustment. Is that correct?

16 A. As a general statement, yes. I would,
17 of course, have to know all the details of a
18 specific to provide, you know, a specific answer,
19 but that would seem the logical place.

20 Q. That account is an operating income
21 account. Is that correct?

22 MS. VON QUALEN: Are you referencing a portion

1 of Mr. Smith's testimony or responses to his DRS?

2 MR. SPRINGER: I'm just asking him a question.

3 A. I'm not sure as I sit here.

4 Q. And if you review a copy of the Uniform
5 System of Accounts, does that assist you?

6 A. Yes. Account 406 would be an operating
7 income account.

8 Q. Thank you.

9 Now you also testified with regard to a
10 reorganization in Central Illinois Public Service
11 Company/Union Electric Docket 95-0551. Is that
12 correct?

13 A. Yes, it is.

14 Q. And would you agree that in that case
15 you testified that if the merger premium were to be
16 recovered through rates, the accounts which would
17 be affected are Account 186, Miscellaneous Deferred
18 Debits, and Account 253, Other Deferred Credits?

19 A. I think I testified to some
20 possibilities in there. Being characterized did I
21 testify to that is what should happen or would
22 happen, I can't go that far as I sit here without

1 looking at all the testimony and revisiting the
2 entire docket.

3 Q. Let me show you a copy of your direct
4 testimony in that docket and just ask you to read
5 the first sentence of the answer to question 17 in
6 that case.

7 A. Okay. "If the merger premium which is
8 being transferred to the CIPSCO shareholders is to
9 be recovered through rates, then the accounts which
10 would be affected are Account 186, Miscellaneous
11 Deferred Debits, and Account 253, Other Deffered
12 Credits." I mean those are the words there, but,
13 again, I can't as I sit here address the
14 significance of my reference here or my statement.
15 Whether my statement would apply to all situations
16 or not I don't know because I don't know the
17 specific context of what I'm addressing here.

18 Q. All right. But that was your statement
19 in that case. Would you agree with that?

20 A. Those are the words on that page or at
21 that part of my testimony, yes.

22 Q. Now the Commission does not commit

1 itself to the approval or acceptance of any items
2 set out in any account of the Uniform System of
3 Accounts for the purpose of fixing rates or in
4 determining other matters before the Commission,
5 such as security issues, original cost termination,
6 or contract approvals. Correct?

7 A. The fact that a cost is recorded
8 appropriately in an account does not determine
9 agreement or consent or authorization by the
10 Commission of how that item is treated for
11 ratemaking purposes.

12 Q. The Commission approved what the
13 companies and the Commission described as savings
14 plans in Dockets 98-0555 and 98-0866, which you
15 reference in your direct testimony at page 2.
16 Correct?

17 A. Yes.

18 Q. You were not directly involved in either
19 of those proceedings. Correct?

20 A. Correct.

21 Q. At page 4 of your direct testimony, at
22 least my copy of it, lines 86 and 87, you state,

1 "there is no line, or category, in the development
2 of the revenue requirement at which savings can be
3 placed." Is that correct?

4 A. That's correct.

5 Q. This statement is not based on any
6 familiarity that you may have with the accounting
7 approach which might or might not have been
8 approved in Docket 98-0555 or 98-0866. Correct?

9 A. No. My statement was based on my
10 knowledge of development of the revenue requirement
11 formula rather than any knowledge -- any specific
12 knowledge of the dockets that you reference.

13 Q. And in developing your testimony, you
14 did not rely on any regulatory commission decision
15 from a state other than Illinois which addresses
16 savings sharing plans. Correct?

17 A. Could I have the question back?

18 Q. I can ask it again, if you want.

19 A. That's fine.

20 Q. In developing your testimony, you did
21 not rely on any regulatory commission decision from
22 a state other than Illinois which addresses a

1 savings sharing plan. Correct?

2 A. What I relied upon was my knowledge of
3 the ratemaking process, my knowledge of revenue
4 requirement directives of this Commission in
5 general rather than relying upon the directives of
6 alternative or saving plans of other states.

7 Q. All right.

8 Utility companies are entitled to earn a
9 reasonable rate of return on the value of their
10 property. Is that correct?

11 A. Yes.

12 Q. At page 11 of your direct testimony you
13 refer to a regulatory asset as representing the
14 difference between the original cost of assets and
15 the price paid for assets. Is that correct?

16 EXAMINER SHOWTIS: Line 252 to 253?

17 MR. SPRINGER: Yes.

18 A. The Company describes regulatory asset.
19 I'm describing my understanding of what the
20 Company's definition or description of regulatory
21 asset is, and I'm doing that at that point.

22 Q. Okay. Now you agree that for purposes

1 of applying SFAS 71, that on page 9, beginning at
2 line -- excuse me. Let me find the correct
3 reference. Let me start the question over.

4 You agree that for purposes of applying
5 SFAS 71, that on page 9, beginning at line 19 of
6 his testimony, Mr. Ruckman defines the regulatory
7 asset as being the accumulated excess of amortizing
8 expense under the straight line method over the
9 expense recognized under the home mortgage method.
10 Is that correct?

11 MS. VON QUALEN: Do you have a copy of
12 Mr. Ruckman's testimony?

13 A. No, I don't.

14 MS. VON QUALEN: Do you need a copy?

15 A. Is that a data request?

16 Q. 28.

17 A. 28? Okay. And the question is?

18 Q. Would you like the question again?

19 A. Yes, please.

20 Q. You agree that for purposes of applying
21 SFAS 71, that on page 9, beginning at line 19 of
22 his testimony, Mr. Ruckman defines the regulatory

1 asset as being the accumulated excess of amortizing
2 expense under the straight line method over the
3 expense recognized under the home mortgage method.
4 Is that correct?

5 A. Yeah, that's correct. I think the
6 proper -- the appropriate word is amortization. I
7 think it was mispronounced as amortizing.

8 Q. This is also the regulatory asset you
9 intend to refer to. Is that correct?

10 A. Yes.

11 Q. So there's no disagreement between you
12 and Mr. Ruckman over the regulatory asset.

13 A. Not in terms of the application of SFAS
14 71.

15 Q. In your rebuttal testimony, lines 66 to
16 68, you state, "Whether it is reasonable to develop
17 a plan to share savings and subsidize this merger
18 is a policy question for the Commission and not
19 something which I am addressing." Is that correct?

20 A. Yes, that's correct.

21 EXAMINER SHOWTIS: Would you repeat that
22 reference again, Mr. Springer?

1 MR. SPRINGER: Yes. It's page 3, lines 66 to
2 68.

3 EXAMINER SHOWTIS: Okay.

4 Q. So you do not view your testimony as a
5 policy recommendation.

6 A. No. The intent of my testimony is to
7 address the mechanics of the Company's proposal and
8 how that will impact rates or could impact rates.

9 Q. At page 3, line 68, same page, you
10 indicate there your belief that the Savings Sharing
11 Proposal offered by the Company does not share
12 savings. Is that correct?

13 A. That's correct.

14 Q. And you believe this because the
15 proposal increases the revenue requirement for the
16 cost necessary to transact the acquisition of
17 assets. Is that correct?

18 A. That is part of it. I find several
19 things wrong with the Company's plan which in
20 reality I think negate the possibility that savings
21 would be shared. I think the plan as a whole fails
22 to share savings.

1 Q. All right. Please refer to your
2 rebuttal testimony. At page 3, beginning at line
3 68 --

4 A. Could you wait just a second, please?

5 Q. Are you ready?

6 A. Just a second, please. Okay. I'm
7 there.

8 Q. There you state what we referred to, the
9 plan offered by the Company does not share savings.
10 You then state the Company's proposal increases
11 revenue requirement for the cost necessary to
12 transact the acquisition of assets. Is that
13 correct?

14 A. That's correct, yes.

15 Q. As you explain it, the acquisition cost
16 is then reduced to an amount no greater than a
17 portion of the savings resulting from the merger.
18 Is that correct?

19 A. Yes, that's correct.

20 Q. Now you don't know what opinion you
21 might have with regard to a savings sharing plan
22 which did not tie the shareholder portion of

1 savings to an acquisition revenue requirement. Is
2 that correct?

3 A. Yes. The only opinions I'm offering are
4 to the sharing savings plan and the Company's
5 alternative treatment.

6 Q. Okay. At page 13 of your rebuttal
7 testimony, beginning at line 280, you state that
8 the Company is suggesting that the Commission
9 should approve the model at this time and not be
10 concerned about reliability of input data until the
11 model is used in a practical setting. Is that
12 correct?

13 A. That's correct.

14 Q. You are not suggesting that the
15 Company's position is that the Commission should
16 not be concerned about the reliability of the input
17 data. Is that correct?

18 A. No. I was addressing some testimony of
19 the Company that indicated that reliability could
20 be addressed at a later date.

21 Q. So you're referring there to the
22 Company's view that under the Savings Sharing

1 Proposal, savings are measured in future rate cases
2 during the term of the proposal. Is that correct?

3 A. Could you read that or ask it again,
4 please?

5 Q. Yes. You are referring there then to
6 the Company's view that under the Savings Sharing
7 Proposal, savings are measured in future rate cases
8 during the term of the Savings Sharing Proposal.
9 Correct?

10 A. Yes.

11 Q. At page 15 of your rebuttal testimony,
12 beginning at line 34 -- excuse me. That might not
13 be a correct reference. Let me find the right one.
14 It's line 341. You state that it will be
15 impossible to know what the operating conditions of
16 Citizens would be five years from now on a
17 stand-alone basis if Citizens is consolidated with
18 Illinois-American in the near future. Is that
19 correct?

20 A. Yes, it is.

21 Q. And you did not rely on any specific
22 studies, analyses, regulatory orders, texts, or

1 workpapers in making this statement. Correct?

2 A. No. This statement is based on my
3 knowledge and experience of regulated utilities and
4 not on any specific documents.

5 Q. At page 12 of your rebuttal testimony,
6 line 277, you refer to the term "model". Is that
7 correct?

8 A. I use that term, yes.

9 Q. And the model you are referring to is
10 the Savings Sharing Proposal as it is discussed by
11 Mr. Flaherty. Is that correct?

12 A. I use that term to reference -- I use
13 the term "any" prior to that, so I'm referencing
14 all models, but specifically the savings sharing
15 plan, yes.

16 Q. Until the model is applied in future
17 cases, your view is that we cannot know if the
18 savings sharing plan is reasonable. Is that
19 correct?

20 A. Yes. This model to my knowledge has
21 never been tested. The inputs that would be
22 required have never been experienced in any other

1 form or format or any other case, so it's my
2 opinion until we have practical experience with
3 this model that we can't know what the outcome
4 would be.

5 Q. In other words, we can't know whether it
6 would be reasonable or not to utilize.

7 A. That's correct.

8 Q. And the basis for your view is all of
9 your educational and professional experience. Is
10 that correct?

11 A. Yes.

12 Q. All reasonable thought requires one to
13 accept that one cannot know how something works
14 until we observe the process. Is that correct?

15 A. Even though I used -- probably used the
16 term all, I may pull that out. Extremes. Nothing
17 is perfect, but reasonable thought. There may be
18 exceptions.

19 MR. SPRINGER: Thank you. That's all the
20 questions I have for Mr. Smith.

21 EXAMINER SHOWTIS: Mr. Fitzhenry?

22 MR. FITZHENRY: I don't have any questions.

1 EXAMINER SHOWTIS: I just had a couple
2 questions.

3 EXAMINATION

4 BY EXAMINER SHOWTIS:

5 Q. Do you believe that merger or
6 acquisition savings can be tracked over some period
7 of time?

8 A. It's a matter of degree. As I'm using
9 the term savings, that's the difference between in
10 this case the cost of service of Citizens as would
11 be as owned or merged with Illinois-American and
12 the cost of service of operating Citizens on a
13 stand-alone basis. I believe in my testimony I
14 indicated, yeah, probably the first day after the
15 merger we'd have a pretty good idea of what the
16 cost of operating Citizens would be on a
17 stand-alone basis. Forty years into the future I
18 don't think we'd have any idea of reasonably how we
19 could calculate that cost on a stand-alone basis.

20 Q. Okay.

21 A. As time progresses, you know, from one
22 day to forty years, the difficulty in calculating

1 the cost of operating Citizens on a stand-alone
2 basis becomes much -- increases, so. Early on,
3 yeah, you probably could come up with a fair
4 substitute or a fair determination of the cost of
5 operating Citizens.

6 Q. The Commission entered two orders
7 pertaining to the telecommunications industry, the
8 GTE/Bell Atlantic merger and the SBC/Ameritech
9 merger, where it concluded that there should be a
10 50/50 sharing of net savings, and I believe the
11 Commission disallowed recovery of certain costs
12 that it characterized as transaction costs versus
13 other costs associated with the merger. Do you
14 believe that if a sharing of costs -- I'm sorry.
15 Strike that.

16 Do you believe that -- leave that first
17 rambling sentence in there.

18 Do you believe that if the Commission
19 authorizes the sharing of savings, whether it 's
20 just net savings or absolute savings, that there
21 would have to be some way to track those savings?

22 A. Well, --

1 Q. In other words, if savings cannot ever
2 be tracked, how could there ever be a decision that
3 would authorize a sharing of something that's
4 impossible to determine?

5 A. And I guess that's to some extent the
6 trouble I have. I think in terms of looking at it
7 on a long-term basis, I don't know that I can
8 personally envision a mechanism that would
9 adequately track the savings, so maybe I'm having a
10 little trouble with the premise, but certainly if
11 some sharing is to occur, I think it's reasonable
12 that a mechanism would have to be developed to
13 track that savings just like a mechanism is needed
14 to track costs.

15 Q. Okay. But I take it it's your position
16 that the longer the period over which savings are
17 tracked, the harder it becomes to attempt to
18 determine what savings would actually have been.

19 A. Yeah. That's because we have to make
20 more assumptions as time increases.

21 EXAMINER SHOWTIS: Okay. That's all the
22 questions I had.

1 MS. VON QUALEN: Could we have a brief recess?

2 EXAMINER SHOWTIS: Okay.

3 (Whereupon a short recess

4 was taken.)

5 EXAMINER SHOWTIS: Back on the record.

6 MS. VON QUALEN: I have a couple questions.

7 EXAMINER SHOWTIS: Okay.

8 REDIRECT EXAMINATION

9 BY MS. VON QUALEN:

10 Q. Mr. Smith, do you recall being asked if
11 utilities should be able to earn a reasonable rate
12 of return on the value of property?

13 A. Yes.

14 Q. Do you have any further explanation or
15 clarification to your response?

16 A. Yes. I'd like to point out that in
17 Illinois, authorized return is calculated by
18 applying the authorized rate of return to the
19 original cost rate base.

20 MS. VON QUALEN: Thank you. That's all the
21 questions I have.

22 MR. SPRINGER: No follow-up.

1 EXAMINER SHOWTIS: No questions. You may step
2 down.

3 (Witness excused.)
4 (Whereupon at this point in
5 the proceedings an
6 off-the-record discussion
7 transpired, during which
8 time ICC Staff Exhibit 11.0
9 was marked for
10 identification.)

11 EXAMINER SHOWTIS: Let's go back on the
12 record.

13 Mr. King, you presented some testimony
14 on the stand. You might have been one of the two
15 or three that wasn't sworn the first day. Would
16 you raise your right hand.

17 (Whereupon Roy A. King was
18 sworn by Examiner Showtis.)

19 EXAMINER SHOWTIS: I think I'll leave the --
20 if you're going to stay for Mr. Borden, Mr.
21 Fitzhenry, I'll just give the instructions with
22 regard to briefs after Mr. Borden's

1 cross-examination is concluded, and I don't think
2 Mr. Borden was sworn either.

3 MR. BORDEN: No.

4 EXAMINER SHOWTIS: Would you raise your right
5 hand.

6 (Whereupon David Borden was
7 sworn by Examiner Showtis.)

8 EXAMINER SHOWTIS: You may proceed.

9 DAVID A. BORDEN

10 called as a witness on behalf of the Staff of the
11 Illinois Commerce Commission, having been first
12 duly sworn, was examined and testified as follows:

13 DIRECT EXAMINATION

14 BY MS. VON QUALEN:

15 Q. Please state your name for the record.

16 THE WITNESS:

17 A. David A. Borden, last name spelled
18 B-O-R-D-E-N.

19 Q. Who is your employer and what is your
20 business address?

21 A. I work at the Illinois Commerce
22 Commission, 527 East Capitol Avenue, Springfield,

1 Illinois 62701, and I work in the Energy Division,
2 Policy Section.

3 Q. Did you prepare written exhibits and
4 schedules for submittal in this proceeding?

5 A. Yes.

6 Q. And do you have before you ICC Staff
7 Exhibit 5.0, Direct Testimony of David A. Borden?

8 A. Yes.

9 Q. Did you prepare this document for
10 presentation in this matter?

11 A. Yes.

12 Q. Do you have any additions or corrections
13 to make to ICC Staff Exhibit 5.0?

14 A. No.

15 Q. Do you also have before you ICC Staff
16 Exhibit 11.0, Rebuttal Testimony of David A.
17 Borden?

18 A. Yes.

19 Q. Did you prepare that exhibit for
20 presentation in this matter?

21 A. Yes.

22 Q. Do you have any additions or corrections

1 to make to Staff Exhibit 11.0?

2 A. Yes, I have one correction. The
3 originally filed exhibit was numbered Exhibit 5.0.
4 That number is incorrect, and it has been corrected
5 with ICC Staff Exhibit 11.0.

6 EXAMINER SHOWTIS: Has a copy of that been
7 provided to the Reporter so that the Reporter can
8 mark it?

9 THE WITNESS: Yes, it has.

10 Q. Is the information contained in ICC
11 Exhibits 5.0 and 11.0 true and correct to the best
12 of your knowledge?

13 A. Yes.

14 Q. If I were to ask you the same questions
15 today, would your answers be the same?

16 A. Yes, they would.

17 MS. VON QUALEN: At this time I ask for
18 admission into evidence of ICC Staff Exhibit 5.0
19 and 11.0.

20 EXAMINER SHOWTIS: Is there any objection?

21 MR. SPRINGER: None.

22 EXAMINER SHOWTIS: Those exhibits are admitted

1 into evidence.

2 (Whereupon ICC Staff
3 Exhibits 5.0 and 11.0 were
4 received into evidence.)

5 MS. VON QUALEN: Mr. Borden is available for
6 cross-examination.

7 EXAMINER SHOWTIS: Mr. Springer.

8 MR. SPRINGER: Thank you.

9 CROSS EXAMINATION

10 BY MR. SPRINGER:

11 Q. Mr. Borden, you have not testified in
12 any prior proceeding regarding a utility
13 reorganization as defined in Section 7-204 of the
14 Public Utilities Act. Is that correct?

15 A. Yes, that's correct.

16 Q. Your recommendation is that Illinois
17 American's proposal to recover the acquisition
18 adjustment through the Savings Sharing Proposal be
19 rejected. Is that correct?

20 A. Yes.

21 Q. You indicate at the bottom of page 3 of
22 your direct testimony and continuing on page 4 that

1 by allowing the Company to recover the acquisition
2 adjustment from ratepayers through the mechanics of
3 the Company's savings proposal, ratepayers will
4 subsidize a transaction cost of the merger through
5 utility funds. Is that correct?

6 A. Yes.

7 Q. In referring to the acquisition
8 adjustment as a transaction cost, you relied, in
9 part, on the Commission's orders in SBC/Ameritech
10 Docket 98-0555, GTE/Bell Atlantic Docket 98-0866,
11 and Illinois-American Water Company /Northern
12 Illinois Water Corporation Docket 99-0418. Is that
13 correct?

14 A. Yes, that's correct. I believe those
15 are referenced in my testimony and also in some
16 data responses as well.

17 Q. None of these orders, however, address
18 recovery of an acquisition adjustment or merger
19 premium. Is that correct?

20 A. That is correct.

21 Q. Another order you relied on is the order
22 in Illinois-American Water Company/United Water

1 Illinois Docket 99-0457. Is that correct?

2 A. Yes.

3 Q. In that order the Commission approved a
4 stipulation which included an agreement not to
5 reflect a merger premium in rates. Is that
6 correct?

7 A. Yes, that's my understanding.

8 Q. The Commission approved the stipulation
9 with the understanding that it did not constitute a
10 precedent for future proceedings. Is that correct?

11 A. Yes.

12 Q. Aside from the four orders just
13 discussed, you rely on no other orders or other
14 documents for your position that the acquisition
15 adjustment is a transaction cost. Correct?

16 A. That is correct.

17 Q. You agree with the explanation of Staff
18 witness Smith regarding plant acquisition
19 adjustments, as set forth in ICC Exhibit 1, page 6.
20 Is that correct?

21 A. Yes, and I believe again that was a data
22 request from the Company. So if you need a more

1 specific answer, I'd appreciate referral to the
2 request, but that's correct.

3 Q. Okay. As explained by Staff witness
4 Smith at page 6, the acquisition adjustment is a
5 balancing entry which reflects the difference
6 between the original cost of the assets and the
7 price paid for those assets. Is that correct?

8 A. Yes.

9 Q. The acquisition adjustment reflects the
10 compensation negotiated for relinquishing control
11 of the CUCI assets. Is that correct?

12 A. Yes.

13 Q. Under your proposal then, the difference
14 between the price paid and original cost would be a
15 transaction cost, but the remainder of the price
16 paid would not be a transaction cost. Is that
17 correct?

18 A. I do not believe I have a proposal.

19 Q. All right. If I understand, your
20 position is that the acquisition adjustment itself
21 is a transaction cost? Would that be right?

22 A. Yes, that's correct.

1 Q. And the acquisition adjustment, if I
2 understand what we just went through, is the
3 difference between the price paid and the original
4 cost of the assets? Is that correct?

5 A. Yes.

6 Q. So that that portion of the purchase
7 price would be a transaction cost?

8 A. Yes.

9 Q. And the rest of the purchase price,
10 which would be the original cost of the assets, is
11 not a transaction cost?

12 A. Oh, okay. Now I... It would be a
13 transaction cost if that were what the company were
14 paying for in some sense, but for the intents and
15 purposes of my testimony, no, it's not. It doesn't
16 fit that definition.

17 Q. So part of the purchase price is a
18 transaction cost and part is not for purposes of
19 your testimony?

20 A. I guess you could say that, yes.

21 Q. Now your main concern in this proceeding
22 is the proposal to recover the acquisition

1 adjustment through the Savings Sharing Proposal.

2 Is that correct?

3 A. Yes.

4 Q. The Commission does have authority in an
5 appropriate case to allow the recovery of
6 acquisition adjustments. Is that correct?

7 A. Yes, that is correct, and I have not
8 recommended -- I have only seen one proposal from
9 the Company to evaluate.

10 Q. But the Commission does have authority
11 in an appropriate case to allow the recovery of
12 acquisition adjustments?

13 A. Yes.

14 Q. You see merit though in having the
15 Commission decide the disposition of acquisition -
16 related costs on a case-by-case basis. Is that
17 correct?

18 A. Yes.

19 Q. You do not propose that acquisition
20 adjustments be rejected as per se a violation of
21 Section 7-204(b)(2) of the Act. Is that correct?

22 A. Yes, that's correct.

1 Q. At page 12 of your rebuttal testimony,
2 beginning at line 254, you state, "In any event,
3 while the acquisition is beneficial to both CUC and
4 AWW shareholders, there has been no demonstration
5 of impending financial doom for either company in
6 the absence of the acquisition that warrants
7 recovery of the acquisition adjustment from
8 ratepayers." Correct?

9 A. Yes.

10 Q. In making this statement, you recognize
11 that if an acquiring company is no longer
12 creditworthy, the Commission should seriously
13 consider recovery of a portion or all of an
14 acquisition adjustment to avoid the real threat of
15 diminishing -- let me start the question over.

16 A. Okay.

17 Q. Let me start again. In making this
18 statement, you recognize that if an acquiring
19 company is no longer creditworthy, the Commission
20 should seriously consider recovery of a portion or
21 all of an acquisition adjustment to avoid the real
22 threat of service diminishing to levels that may

1 endanger the public health and safety. Is that
2 correct?

3 A. Yes.

4 Q. With regard now to savings sharing, the
5 allocation of a portion of savings to shareholders
6 to compensate them for the risk associated with
7 purchasing utility assets is not a concept you are
8 absolutely opposed to. Is that correct?

9 A. That is correct.

10 Q. You believe that a savings sharing
11 proposal must be carefully evaluated. Is that
12 correct?

13 A. Yes.

14 Q. As we already discussed, it is recovery
15 of the acquisition adjustment through the savings
16 sharing proposal which is your main problem. Is
17 that correct?

18 A. Yes.

19 Q. So in your view, an appropriate savings
20 sharing proposal would not include a component
21 based on an acquisition revenue requirement.
22 Correct?

1 A. That would be one aspect of it, yes.

2 Q. In your rebuttal testimony at page 4,
3 beginning at line 84, you state there is a
4 reasonable expectation that foregone cost
5 decreases, as a result of rejecting this merger,
6 may be worthwhile if greater cost decreases are
7 realized from another acquiring entity. Is that
8 correct?

9 A. Yes.

10 Q. You cannot identify any other specific
11 proposal by an entity to acquire the water /
12 wastewater assets of CUCI because you know of none.
13 Correct?

14 A. Yes, that's correct.

15 Q. You have no specific correspondence,
16 studies, analyses, or other documents indicating
17 that there is another specific acquisition
18 proposal. Correct?

19 A. I have none of those. I only have --
20 but I do have the understanding that the water
21 industry is undergoing considerable consolidation,
22 and Citizens Utilities Company has expressly

1 indicated their desire to exit this industry and
2 sell its water and wastewater utility assets.

3 Q. You understand that if another
4 acquisition proposal were to some day develop,
5 Citizens Utilities may not be willing to sell its
6 assets at a price lower than the one agreed to in
7 this proceeding. Correct?

8 A. That's correct, and that would indicate
9 to me that Citizens does not -- Citizens must feel
10 it is profitable for them to maintain the
11 operations of Citizens Utilities Company.

12 MR. SPRINGER: I'm going to ask for the
13 portion of the answer or portion of the statement
14 after the response to the question be stricken.

15 MS. VON QUALEN: The witness is allowed to
16 give a complete answer to the question to complete
17 his thought.

18 EXAMINER SHOWTIS: The last portion of the
19 answer will be stricken. If you want to bring up
20 that point on redirect, you can.

21 Q. Please turn now to page 22 of your
22 rebuttal testimony.

1 A. Okay.

2 Q. There you indicate, beginning at line
3 475, that you do not believe the proposal submitted
4 in this proceeding is the only viable proposal that
5 ratepayers must take and the Commission must
6 approve. Correct?

7 A. Yes. I believe I'm off a few lines.

8 Q. It's the sentence that starts on my line
9 473, "Unlike Mr. Flaherty".

10 A. I am in that same response. Maybe it
11 might be when I changed the heading.

12 Q. It's about five lines up from the end of
13 the response.

14 A. Okay. Yes.

15 Q. Where it says "because I do not believe
16 that the current proposal is the only viable
17 proposal that ratepayers must take and the
18 Commission must approve."

19 A. Yes.

20 Q. Do you see that?

21 A. And just to -- and in case there's some
22 discrepancy between what you have, that's on 490,

1 and, you know, there might have been some change in
2 the line numbering when I changed the heading on
3 this, and I'll give you guys a copy of that.

4 Q. Thank you.

5 Now when you use the word "viable" in
6 that statement, you mean to refer to a proposal
7 having terms and conditions of the transaction
8 which result in it being financially successful.
9 Correct?

10 A. Yes, that's true.

11 Q. You do not know of any viable proposals
12 other than the one in this case with regard to
13 acquisition of the CUCI assets. Correct?

14 A. That is correct.

15 Q. At page 26, beginning at line 554 of my
16 copy, this is the beginning of the second to the
17 last response, you state, "I neither agree nor
18 disagree, but I seriously doubt that the ICC will
19 miss its one and only chance to assure affordable
20 and quality service for the customers of CUCI, if
21 the Commission rejects the acquisition of CUCI by
22 IAWC." Is that correct?

1 A. Yes, that is.

2 Q. You do not have any study, analysis, or
3 workpaper or other document to support this
4 statement. Correct?

5 A. I'm basing that, again, on my knowledge
6 of the water industry being under -- undergoing
7 consolidation and Citizens explicitly indicating
8 its desire to exit the industry.

9 Q. What I'm asking, Mr. Borden, is --

10 A. I have no other studies or analyses
11 other than that.

12 Q. Thank you.

13 MR. SPRINGER: That's all the questions we
14 have for Mr. Borden.

15 EXAMINER SHOWTIS: I just had a couple
16 questions.

17 EXAMINATION

18 BY EXAMINER SHOWTIS:

19 Q. Mr. Springer asked you a question that
20 pertained to circumstances under which you believe
21 an acquisition -- recovery of an acquisition
22 adjustment in whole or in part would be proper. Do

1 you remember that question?

2 A. Yes, I do.

3 Q. Just so I'm clear, is that the only
4 circumstance under which you believe recovery of an
5 acquisition adjustment in whole or in part would be
6 appropriate, or are there other situations where
7 you believe recovery may be appropriate?

8 A. Those are the only ones I agree to. I'm
9 willing to review any proposal that the Company has
10 to offer, but those are the only circumstances at
11 this point that I am willing to agree to.

12 Q. Just so I'm clear, if the Commission did
13 not allow recovery of the acquisition adjustment
14 through revenue requirement, are you taking any
15 position as to what appropriate treatment should be
16 with regard to allocation of savings?

17 A. I've recommended rejection of the
18 Company's proposal.

19 Q. Well, that's correct, but obviously
20 there's a proposal before the Commission. I think
21 the Commission has latitude to decide within the
22 context of the record what is most appropriate, and

1 in making that decision the Commission would
2 attempt to balance the interest of ratepayers and
3 shareholders. So I'm just trying to understand if
4 you have any position that pertains to a situation
5 where the acquisition revenue requirement was not
6 part of a savings proposal or savings plan that was
7 approved by the Commission.

8 A. The only allocation of savings that I
9 have indicated in data responses and possibly
10 referred to in comments in my testimony that I can
11 state is reasonable with certainty is 100 percent
12 allocation to the ratepayer.

13 Q. And one final question. Do you believe
14 that that position is or is not consistent with how
15 the Commission has treated merger or acquisition
16 savings in the past?

17 A. 100 percent allocation? I think it's
18 consistent with how the Commission has ruled in the
19 past.

20 EXAMINER SHOWTIS: That's all I have.

21 MS. VON QUALEN: If we could have a minute or
22 two.

1 EXAMINER SHOWTIS: Okay.

2 (Whereupon a short recess
3 was taken.)

4 EXAMINER SHOWTIS: Back on the record.

5 MS. VON QUALEN: I have a few redirect.

6 EXAMINER SHOWTIS: Okay.

7 REDIRECT EXAMINATION

8 BY MS. VON QUALEN:

9 Q. Mr. Borden, you were asked about your
10 testimony regarding financial doom. Would you like
11 to further explain your answer?

12 A. Yes. I'd just like to add that the
13 Commission should also reject the transaction if it
14 would bring about financial doom for the acquiring
15 company as well. If you want to use the term
16 impair their creditworthiness for financial doom,
17 that would be acceptable to me as well.

18 Q. Mr. Springer also asked you if you are
19 aware of other viable proposals. Would you like to
20 give us a clarification of your answer?

21 A. Yes. I'd just like to clarify that I do
22 not consider the Company's proposal to be a viable

1 proposal, and that I could have no knowledge of any
2 other proposals, viable or not, that may have been
3 made to Citizens Utilities Company.

4 MS. VON QUALEN: I have no further questions.

5 MR. SPRINGER: I do have a couple of
6 follow-up, Mr. Examiner.

7 EXAMINER SHOWTIS: Go ahead.

8 RECROSS EXAMINATION

9 BY MR. SPRINGER:

10 Q. Did I hear you correctly, Mr. Borden?
11 You said you could have no knowledge of other
12 proposals?

13 A. I'm sorry. I'd like to clarify. I do
14 have no knowledge.

15 Q. Thank you.

16 A. You're correct.

17 Q. I just wanted to clear that up.

18 You indicated that a transaction should
19 be rejected if it would give rise to financial doom
20 for the acquiring company, if I heard you. Is that
21 correct?

22 A. Yes.

1 Q. And then you mentioned impairing the
2 creditworthiness of the acquiring company?

3 A. Yes, that is correct.

4 MR. SPRINGER: That's all the questions I
5 have.

6 EXAMINER SHOWTIS: Okay. You can step down.

7 THE WITNESS: Thank you.

8 (Witness excused.)

9 EXAMINER SHOWTIS: I would like to state for
10 the record the briefing schedule which has been
11 accepted by the parties.

12 The deadline for initial briefs is
13 February 23, 2001. That is an in-hand date to the
14 parties, and that can be in-hand by e-mail.

15 The deadline for reply briefs is March
16 2nd. I would like to see the briefs that day, so
17 that would be an in-hand date to me, and that can
18 be e-mailed, too, if the parties want to do it that
19 way.

20 The target date for my HEPO is March
21 23rd. I will allow fourteen days for exceptions
22 and seven days for replies no matter what the date

1 is on which my HEPO is issued.

2 I would ask that the Joint Applicants
3 submit a draft order at the time that it submits
4 its reply brief.

5 The page limitation for the initial
6 briefs is 100 pages and for reply briefs is 75
7 pages. I would ask all the parties to make their
8 arguments as concise as possible, and hopefully
9 they won't see a need to reach those page levels.

10 The briefs should be organized in the
11 following manner. I think the first part of this
12 instruction would apply mainly to the Joint
13 Applicants. If the Joint Applicants want to
14 present background information and then an overview
15 of their proposal, they can do so in the first part
16 of the brief.

17 The next part of the brief should
18 address issues under Section 7-204(c) of the Act,
19 and those issues obviously pertain to the treatment
20 of the acquisition adjustment, or some parties call
21 it the merger premium, and also allocation of
22 savings.

1 The next part of the brief should
2 address the criteria set forth in Section 7-204(b)
3 of the Act, and I believe there are seven criteria
4 there, so they should be listed in order. I
5 realize some of those sections are not in dispute,
6 but that can be made clear in the brief.

7 Then the last part of the brief should
8 address other issues besides the issues pertaining
9 to Section 7-204(c) and 7-204(b). An example would
10 be if there are any accounting issues that remain.

11 I don't think there's a need for an
12 another prefatory portion in the reply brief, but I
13 would like to see the reply briefs organized in the
14 same manner, 7-204(c) addressed first, 7-204(b)
15 addressed next, and then remaining issues
16 addressed.

17 MR. FITZHENRY: Will your HEPO be e-mailed to
18 the parties?

19 EXAMINER SHOWTIS: If we have an e-mail
20 address, which I think we do, I think we can see to
21 it that that happens.

22 MR. FITZHENRY: Thank you.

1 EXAMINER SHOWTIS: Is there anything else to
2 discuss on the record?

3 MR. SPRINGER: We're aware of nothing.

4 MR. CLENNON: Staff has nothing at this time.

5 EXAMINER SHOWTIS: Okay. Then the record will
6 be marked Heard and Taken.

7 HEARD AND TAKEN

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1 STATE OF ILLINOIS)
)SS
2 COUNTY OF SANGAMON)

3 CASE NO.: 00-0476

4 TITLE: ILLINOIS-AMERICAN WATER COMPANY,
 CITIZENS UTILITIES COMPANY OF ILLINOIS and
5 CITIZENS LAKE WATER COMPANY

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CERTIFICATE OF REPORTER

9

10 I, Cheryl A. Davis, do hereby certify that I
11 am a court reporter contracted by Sullivan
12 Reporting Company of Chicago, Illinois; that I
13 reported in shorthand the evidence taken and
14 proceedings had on the hearing on the
15 above-entitled case on the 2nd day of February,
16 2001; that the foregoing pages are a true and
17 correct transcript of my shorthand notes so taken
18 as aforesaid and contain all of the proceedings
19 directed by the Commission or other persons
20 authorized by it to conduct the said hearing to be
21 so stenographically reported.

22 Dated at Springfield, Illinois, on this 3rd
 day of February, A.D., 2001.

17

18

19 Certified Shorthand Reporter
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21

22